Law and Governance in an Enlarged European Union

This book's principal aim is to critically address the institutional and substantive legal issues resulting from European enlargement, concentrating on the legal foundations on which the enlarged Union is being built. The accession of new Member States creates the potential for a stronger and more powerful Europe. Realising this potential will depend on the ability of the EU to develop functional and effective governance structures, both at the European level and at the level of the individual Member States. While the *acquis communautaire* will ensure that formal laws in the new Member States will be aligned with those of existing members, the question remains as to how effective the new Member States' institutions will be in implementing changes, and what effects the imposed changes will have on the legitimacy of the new legal framework.

This book, containing the work of leading legal scholars and social scientists from Europe and the US, examines the current and future legal framework for EU governance, and the role that new members will — or will not — play in the creation of that framework, paying particular attention to the specific challenges membership in the EU poses to the acceding states of Central and Eastern Europe. It is a book which should contribute to and influence debates over constitutionalism and legal harmonisation in the EU.

Law and Governance in an Enlarged European Union

Edited by
George A Bermann
and
Katharina Pistor

Columbia Law School, New York

OXFORD AND PORTLAND, OREGON
2004

Published in North America (US and Canada) by
Hart Publishing
c/o International Specialized Book Services
5804 NE Hassalo Street
Portland, Oregon
97213-3644
USA

Hart Publishing is a specialist legal publisher based in Oxford, England.
To order further copies of this book or to request a list of other publications please write to:

Hart Publishing, Salters Boatyard, Folly Bridge,
Abingdon Rd, Oxford, OX1 4LB
Telephone: +44 (0)1865 245533 Fax: +44 (0) 1865 794882
email: mail@hartpub.co.uk
WEBSITE: http//:www.hartpub.co.uk

British Library Cataloguing in Publication Data
Data Available

ISBN 1-84113-426-0 (hardback)

Typeset by Olympus Infotech Pvt Ltd, India, in Sabon 10/12 pt.
Printed and bound in Great Britain by
MPG Books Ltd, Bodmin, Cornwall

To my parents, Mae Gordon Bermann and Sigmund Dressler Bermann

G.A.B.

To the memory of my sister Regina Elisabeth Pistor

K.P.

Acknowledgements

The editors wish to acknowledge, with gratitude, the financial support of the Commission of the European Communities, the Columbia Law School, the Harriman Institute at Columbia University's School of International and Public Affairs, and Columbia University's Institute for the Study of Europe. Without that support, this enterprise would not have been possible. We recognise also the valuable collaboration of the Walter Hallstein Institute of the Humboldt University of Berlin, Germany.

Special thanks to William Poulin-Deltour and Darlene Corrigan — successive coordinators of European law programs at Columbia Law School — who saw masterfully to the all-important organisational and editorial aspects of this volume and the underlying workshop activities. Their work in turn owes its efficiency in good measure to the secretarial and editorial assistance of Yahaira Alonzo.

Finally, the editors salute the intellectual contributions and collegiality of the authors and commentators whose work this volume reflects.

Contents

Part III: Corporate Governance

Part IV: Domestic Institution Building in the Shadow of the *Acquis*

List of Contributors

Catherine Barnard is Senior Lecturer in Law, University of Cambridge, Jean Monnet Chair of European Law, and Fellow of Trinity College, Cambridge.

Erik Berglöf is Professor, Director, SITE, Stockholm School of Economics.

George A Bermann is Jean Monnet Professor of European Union Law, Walter Gellhorn Professor of Law, and Director of the European Legal Studies Center, Columbia Law School.

Roland Bieber is Jean Monnet Chair, Professor of European Law, Director of the Center of Comparative Law, European Law and Foreign Legislation, University of Lausanne, Switzerland.

Francesca Bignami is Associate Professor of Law, Duke University School of Law.

Richard M Buxbaum is Jackson H Ralston Professor of International Law, School of Law, University of California, Berkeley.

Gráinne de Búrca is Professor of European Union Law, European University Institute.

Peter Doralt is Professor of Law, Vienna University of Economics and Business Administration.

Frank Emmert is Professor of Law and Director of the Center for International and Comparative Law, Indiana University School of Law, Indianapolis.

Merritt B Fox is Michael E Patterson Professor of Law, Columbia Law School.

Susanne Kalss is Professor of Business and Securities Law, Vienna University of Economics and Business Administration.

Csilla Kollonay Lehoczky is Professor of Law, Legal Studies Department, Central European University and Head of the Labour and Social Law Department, Faculty of Law, Eotvos Lorand University.

Antoine Lyon-Caen is Professor, University of Paris X Nanterre, Senior Researcher, Higher School of Social Sciences (EHESS), President of the Institut International de Paris La Défense.

Anete Pajuste is a PhD Candidate, Stockholm School of Economics.

Ingolf Pernice is Professor of Law, Chair of the Department of Public, International and European Law, Managing Director of the Walter Hallstein Institute for European Constitutional Law of the Humboldt University of Berlin.

Katharina Pistor is Associate Professor of Law, Columbia Law School.

Wojciech Sadurski is Professor of Legal Theory and Legal Philosophy, European University Institute in Florence, and Professor of Legal Philosophy, University of Sydney, Faculty of Law.

András Sajó is University Professor, Central European University.

Guido Schwellnus is a PhD Candidate, School of Politics and International Studies, Queen's University Belfast.

Silvana Sciarra is Professor of Law, Chair of Labour Law, University of Florence.

Joanne Scott is Reader in EU Law, University of Cambridge, and Fellow of Clare College, Cambridge.

Stanisław Sołtysiński is Professor of Law, A Mickiewicz University School of Law, Member of Poland's Codification Commission, a Member of the Board of Directors of "UNIDROIT", and Partner of Soltysinski Kawecki & Szlezak.

Micaela Vaerini is Research Assistant, Center of Comparative Law, European Law and Foreign Legislation, University of Lausanne, Switzerland.

Joseph Weiler is University Professor and Jean Monnet Chair, NYU School of Law, and Professor, College of Europe, Bruges.

Manfred Weiss is Professor of Law, Johann Wolfgang Goethe-University, Frankfurt/Main, Germany.

Antje Wiener is Chair of International Relations, Jean Monnet Chair of European Politics, and Director of the Jean Monnet Centre of Excellence, Institute of European Studies, Queen's University Belfast.

Mirosław Wyrzykowski is Professor of Law, Faculty of Law, Warsaw University, and Justice of the Constitutional Tribunal.

Introduction

GEORGE A BERMANN AND KATHARINA PISTOR

THE EASTERN ENLARGEMENT of the European Union is proceeding on a seemingly much surer path and timetable than the adoption of a formal EU Constitution. It is in a sense paradoxical that the EU could assimilate 10 new Member States — whose accession could not even have been predicted prior to 1989 and which present the Union with unprecedented heterogeneity challenges — more easily than it could restructure itself constitutionally, even though all the issues surrounding the constitutional discussion have been around and debated for decades.

The paradox may be apparent only, for eastern enlargement has very largely been viewed as a geopolitical imperative practically ever since the fall of the Berlin Wall, while the need for an EU Constitution as such has been anything but a foregone conclusion. It is therefore easy to imagine that states might be tempted to derail a new Constitution when the political case for doing so seems strong enough, even while blocking the accession of the states of Central and Eastern Europe may have become politically unthinkable.

The necessity of enlargement does not however guarantee its smoothness, much less its success. It is the purpose of this book to address the legal challenges — both institutional and substantive — resulting from the current enlargement. Accession of the 10 new Member States creates the potential for a stronger and more powerful Europe. Realising this potential, however, will depend on Europe's ability to develop functional and effective governance structures, both at the European and the Member State level. The difficulties that the EU has at times encountered in developing common policies with only 15 Member States are well known, and this accession can only heighten them. In that sense, enlargement necessitates a revised framework conducive to effective and legitimate decision-making processes at the Union level.

Governance issues also lie at the heart of the transition process within the accession states. It was just over 15 years ago that the states of Central and Eastern Europe emerged from socialism, with its characteristic centrally-planned economies and single-party political regimes. This same period witnessed accelerated legal and institutional change impelled by the requirement that the new states have fully implemented the a*cquis communautaire*

by the time of their entry into the Union. Moreover, it was clearly never enough that the law on the books of the new Member States mirror the a*cquis*. What was and is also required is the a*cquis*' effective implementation in the new Member States and some assurance that the legal and policy changes entailed in that implementation will not impair the legitimacy of these states' new legal framework.

To assess the emerging governance structures at both the European and national levels, we invited leading experts on Europe from law, economics, and political science to contemplate the challenges that we discerned, and to identify still others that might escape early notice, through a workshop held at Columbia Law School in April 2003. In addition to representing different scholarly fields of endeavour, the participants represent, geographically, both Europe (western as well as eastern) and the United States. The contributions to this volume reflect the fruits of this exercise. It is our hope that the research and reflection presented here will contribute to, and usefully influence, not only enlargement-related policies, but also ongoing debates over constitutionalism in Europe and the policy governing future legal harmonisation in the EU, while at the same time triggering new research in core aspects of European integration.

Reflecting its institutional and substantive focus, the book is organised around four major topics: 'The Legal Foundations of the Enlarged European Union'; 'The Governance of Labour Relations'; 'Corporate Governance'; and 'Domestic Institution Building in the Shadow of the *Acquis*'. We believe that these four themes, while by no means exhaustive, reflect the major challenges that enlargement presents as we move beyond 1 May 2004.[1] They address governance of the European Union, the governance of particular aspects of the common market — labour and firms — and, last but not least, governance within the new Member States in the wake of accession.

Each of these topics poses questions that are intricate in their own right, and experts are typically devoted to only one of them. Yet all of them are highly interrelated. Governing the European Union is, of course, about the institutions of the EU, the voting rights of the Member States, and the allocation of competences between the Union and the Member States. However, the transformation of European governance structures over the past several years from hierarchical and legalistic models to new forms of coordination and mutual learning — often referred to as the open method of coordination (OMC) — poses additional challenges for the institutions of the EU as well as for relevant actors at the Member State level. Whether Europe will be able to develop a governance structure that can live up to this task is an important question.

[1] The Accession Treaty entered into force on 1 May 2004. See Art 2 (2) Accession Treaty of 23 September 2003, OJ L236/17.

So too is the question whether the 25 Member States of the European Union have the institutional capacity not only to implement EU directives and guidelines, but also to participate in the development of new governance structures. Local capacity-building has been an enormous challenge for most of the new Member States, in particular the former socialist countries. The accession process has facilitated this building process, as it has given governments in these countries a clear incentive to formulate policies and participate in the transfer of knowledge and expertise needed to implement them. Yet, at the same time, this 'external anchor' risks undermining capacity-building at the local level. The relevant political actors and administrators in the new Member States have invested heavily in acquiring the skills necessary to ensure compliance with the *acquis* and thus timely accession of their countries to the EU. Some of these resources, however, may have been needed to develop skills and build institutions that would allow them to respond effectively to domestic problems and domestic constituencies.

The multi-level challenges that have always been there, but that enlargement exacerbates, may be viewed in purely institutional terms. But we are convinced that they take on an appropriately greater reality and urgency when viewed in a substantive context, especially contexts that directly implicate such crucial factors of production as labour and firms. Hence our attention to corporate governance and labour regulation as arenas of EU policy-making.

The interrelatedness of the emergent governance structures in Europe is reflected in several themes that run throughout the book. First, governance in the EU is not and has never been a question of *either* European governance *or* governance at the Member State level. Both are interdependently present. Governance of the EU depends on the commitment of the Member States to participate in the making of European law and policy and their implementation within national territory. From the new Member States' perspective, a voluminous *acquis communautaire* had to be embraced prior to accession, ensuring that, at least to that extent, European law and policies would penetrate law and policymaking within the Member States. It is no exaggeration to say that all the Member States, including the accession states, have come to rely on the leadership of the European Union in core policymaking areas. This entails interaction with all European-level governance structures: the Commission, the Council, a multitude of committees and working groups; agencies, the European courts, and so forth. Fortunately, delays and difficulties in adopting a new constitution will by no means cause this highly complex machinery of policymaking and governance to shut down. But their traditionally integrative energy may weaken if this process takes too long or if political differences surrounding the constitutional project result in a new governance structure that is less than adequately functional.

Second, the common market has become a reality, not only for goods and increasingly for services, but also for capital, although somewhat less

so for labour. As a result, market pressures are forcing policy makers within Member States and at the European level to think not only in terms of their national interests, but also about Europe and the competitiveness of the European market as a whole. Conversely, European law makers are showing an increasing awareness of the impact that European policies may have on the economies and societies of the individual Member States and on their ability to cope with that impact. Tensions between national interests and the policy goals of the EU have time and again delayed the adoption of particular directives and the formulation of new policies. This is especially true with regard to policies that affect not only the free movement of goods, but the free movement of firms and capital, with its inevitable impact on labour, social policy and other domestic concerns. Examples include the long delay in adoption of the European takeover directive and the highly contentious decisions of the European Court of Justice on golden shares.[2] The resulting uncertainties affect the ability of Member States to design their own governance structures over partially privatised firms, and some have not resisted the temptation to block the development of EU law that could negatively affect their domestic constituencies or their own desire for policy control. Thus, Germany successfully derailed the adoption of the takeover directive in 2001 and adopted its own takeover code in 2002.

And yet, commitment to finding a common ground within the EU on such issues has been strong enough to bring adverse parties back to the negotiation table. The resulting compromises may look timid to some, but they also document the resilience of European governance vis-à-vis obstructive national interests. Past conflicts have stimulated experimentation with new governance structures which better respect the pluralistic interests of the peoples and governments of Europe while fostering cooperation among them. The emergent new governance structures are less rigid in that, among other things, they give Member States more room to 'pick and choose'.[3] The danger, of course, is that too much picking and choosing undermines achievement of common objectives. Yet it does allow diversity and a measure of competition among alternative governance models. Meanwhile, market forces are likely to keep a check on nationalism disguised as local experimentation.

Third, local institutions are crucial for developing the governance structures that in the end are required to realise common policy goals. This is best exemplified in the contributions on labour law in this volume. Political debates have revealed substantial tensions among Member States over the desirability of EU-imposed labour regulation, as a consequence of which some of the current Member States have negotiated opt-out clauses of various sorts.[4] Resistance

[2] See Part III on Corporate Governance for details.
[3] See Sołtysinski, ch 12.
[4] See Barnard's discussion of the UK position on the working time directive, ch 7.

to 'top-down' EU regulation of labour matters has positioned this area to assume the lead in experimenting with new forms of governance, including OMC and mutual learning among the social partners (employer organisations and labour unions) within the different Member States. In labour, arguably more than in any other area of EU law, classic regulatory approaches, OMC, and a variety of 'mutual learning' models co-exist.[5]

Deeper reflection and analysis of the functioning of these alternative governance models in practice reveal the crucial importance of social institutions at the Member State level. This is the case not only for the classic regulatory approach, but arguably even more so for the more flexible approach typified by the OMC — a point made by all the contributors to this volume addressing labour law issues. The dominant model for governance of labour matters assumes strong employer organisations, on the one hand, and strong labour unions, on the other. Governance structures that are based on this model may prove largely dysfunctional in Member States that do not have these social institutions in place — as is the case in the UK and in most of the new Member States. Member States have therefore negotiated for opt-out clauses and in some instances simply declined to participate in the process of cooperation and mutual learning. The remedy currently proposed, at least for the new Member States, is first to build social institutions and then have them participate in the joint European project. Whether this will succeed is uncertain given the adverse conditions in certain new Member States,[6] as well as the adverse political conditions in existing states like the UK. But the more general point we would like to emphasise is that local governance matters for EU governance. This may be decidedly the case for labour, given labour's reduced mobility compared to capital and given labour markets' greater fragmentation as compared to markets for goods, capital, and firms. But it is not unique to labour.

Fourth, the development of the new Member States into full-fledged members of the EU requires that they be given space to develop their own institutions 'bottom up' rather than following primarily models imposed 'top down'. As noted, the EU has doubtless served an important function as external anchor in the design of major economic policies. However, the majority of the new Member States are not only nascent market economies, but also nascent democracies. Competition over conflicting policy goals and experimentation with different political and economic agendas is the essence of a pluralistic democratic *polis*. Yet the electorate in many accession states has observed over recent years that, irrespective of whom they may have elected locally, major policy goals have a tendency to be set in Brussels, not in Prague, Warsaw or Budapest. Even if the national economies can be shown ultimately to benefit, there may ensue a lessening of citizens'

[5] See the comment by Lyon-Caen in chapter 10 on Labour Governance.
[6] A point that is elaborated in great detail in Kollonay Lehoczky's contribution, ch 8.

willingness to participate in politics and, more generally, a weakening of the processes of democratisation.

These four themes reveal the paradoxical nature of law and governance in an enlarged Europe. The forces of market integration and convergence — the European project, if you will — all seem to call for an enhanced role for European institutions in governance. Yet, at the same time, effective governance depends on strong Member States with strong local institutions. Viewed in this perspective, the struggle over core policies of the EU, not to mention over the new constitution, reveals not so much old Europe's weakness, but its strengths. Still, a major question is whether the new Member States can live up to a similar task, and whether the old Member States will genuinely allow them to do so. There will be an obvious temptation for some large countries — or European institutions under their influence — to take the lead and force the rest to follow. Such an approach would certainly facilitate decision-making processes and the adoption of major policies. However, the fact remains that their effectiveness will still ultimately rest on the willingness of governments and other constituencies in *all* Member States to implement and comply with them. In sum, governance in Europe rests on negotiation, consensus, and compromise. The increasing heterogeneity among Member States means that compromises may be more difficult to reach, but it will also create additional space for experimentation and learning from which all Member States stand to benefit.

In the remainder of this introduction, we evoke more particularly the main issues that the contributors themselves have addressed. Readers are also referred to the Comments prepared by other workshop participants, which are found in each of the four Parts of the book and which reflect on and respond to the themes and arguments presented in the respective chapters.

THE LEGAL FOUNDATIONS OF THE ENLARGED EUROPEAN UNION

The various contributions in this first part of the book address the impact of enlargement on the legal structure and functioning of EU institutions. Basically, what will the enlarged EU look like institutionally, and what bearing will that shape have on the EU's capacity to perform its essential functions, internally and externally? It is of course, at the very outset, a challenge to isolate the institutional effects of enlargement on a polity that has decided, ostensibly independently of enlargement, to revisit its institutions through a convention to draft and debate a new constitution.

Precisely due to the temporal and subject matter congruence between enlargement and the constitutional convention, this part begins with Ingolf Pernice's analysis of the major institutional changes contemplated by the draft constitution. To what extent, he asks, are those changes driven by the

prospect of enlargement and to what extent are they well adapted to the post-enlargement EU? What emerges from his analysis is a belief that, while a constitutional overhaul of the EU was long called for (indeed long overdue), enlargement has made it an absolute necessity. It is not simply a matter of recognising that the structure of the Commission needs reform or that the qualified majority voting formula in the Council needs redefinition. That much is obvious. For Pernice, what matters is that the less obvious adaptations be attended to as well. Implicated, for example, are the structure of and relations among other institutions, such as the various Presidencies (of the Council, of the European Council and of the Commission) that will represent the more far-flung and heterogeneous post-accession polity. Implicated also are essentially non-institutional aspects of the EU, such as the need for a better definition of citizens' rights and therefore of citizenship, the development of mechanisms by which citizens in the old and new states alike can feel better represented in and demand greater accountability from a 'federal' Council, and even the introduction of an EU revenue-raising power (a matter of particular interest in an EU most of whose new members would benefit from redistributive activities requiring new resources).

While Pernice sees enlargement as heightening the urgency of pre-existing institutional imperatives, Joseph Weiler reminds us that enlargement was itself a constitutional decision, and a momentous one. For constitution-making consists not only of solemnly assembling basic institutions, procedures and rights, but also of defining the polity that is itself being constituted. The post-accession EU is simply not the same as the pre-accession one, however great the effort may be to retain the nomenclature and other properties of those institutions, procedures and rights. Weiler poses the question as to why so profound a constitutional change was not preceded by 'process' that even begins to resemble, in depth of study or range of consultation, the process by which the draft constitutional treaty was elaborated. A whole range of constitutional decisions were made when it was decided that these 10 states would join, all at once and as full-fledged members, as if no other formula were possible. A still more substantive question implicitly raised by Weiler — and implicitly answered by him in the affirmative — is whether the unwritten principles of constitutional tolerance and social solidarity on which the EU was built will sustain the weight of numbers and diversity that enlargement will bring.

If Weiler implies that enlargement has consequences for substantive as well as structural aspects of the constitution, Wojciech Sadurski makes that claim explicit. Surely no substantive constitutional initiative plays a greater role in integrating the accession states into the EU than the Charter of Fundamental Rights, which was proclaimed by the institutions at Nice but which is destined to become an integral, and fully judicially enforceable, part of any formal constitutional document to come. But it is not only that the Charter provides substantive 'glue', helping to bind the accession states

more firmly to the EU they are joining. Rather, some of the substantive debates that accompanied enlargement, and were distinctive of it, in turn changed some basic understandings about the Charter itself. These include both substantive understandings (such as what protection of minorities means) and procedural ones (such as whether and to what extent Member States, old as well as new, should submit to human rights monitoring at the EU level). In these ways, enlargement may have contributed to, and not merely complicated, the EU's constitutional evolution.

Even before enlargement, it was widely assumed that a constitution for the EU could never quite approach the 'tightness' of a constitution of either a unitary or federal nation-state. Enlargement has made it even clearer that any EU constitution would need to be *sui generis*. Francesca Bignami explores one way in which it is likely to be *sui generis*, and that is by placing a premium on informal cooperative regulatory relationships among Member State authorities within the enlarged EU. 'Top-down' regulation may be out of favour these days even in the purely domestic regulatory arena, but it may prove to be entirely inadaptive in an EU of 25 states. We are accustomed lately to observing the role of agency 'networks' in the international context. What enlargement of the EU may bring are increased opportunities for getting the job done through mechanisms that mirror these emerging network-based processes. Such processes are by their nature 'messy', and they promise to be even messier when conducted in a setting like the EU whose identity is itself a work in progress and always, it seems, subject to contestation of one sort or another. The challenge of managing such processes, while ensuring that core EU objectives are achieved — messiness notwithstanding — will in itself be a formidable challenge.

THE GOVERNANCE OF LABOUR RELATIONS

Free movement of labour is among the four freedoms that served as the foundation for the common market. Yet, labour has proved to be much less mobile in practice than has been expected. Moreover, high unemployment rates in the current Member States have prompted them to restrict the free movement of labour from the newly acceding Member States to the extent that the transition period provisions allow, hence temporarily. The relative weakness of the common labour market notwithstanding, or perhaps because of it, the governance of labour relations has become a major topic of discussion in European policy making circles. The lack of explicit legal authority for European-level standard setting, coupled with the aversion of certain Member States to accepting such normative activity in Brussels, has given rise to experimentation with alternative governance structures. Thus alongside traditional legal governance, OMC is playing an increasingly important role in this domain.

In her contribution, Silvana Sciarra addresses the prospects for convergence of labour and social standards across the EU Member States, while stressing the ample evidence around us of mutual learning and of new possibilities spawned by the OMC. It follows that the new Member States are not in this area confronting a ready-made, fully formed or centralised governance structure. Rather, they can participate in forging a new one. What this governance structure will look like and how well it will protect core constituencies remains an open question. In part this will be a function of the legal support the new constitutional framework may, or rather may not, afford to labour and social matters. In part, however, it will be determined by the extent to which social and political actors are able and willing to learn from experience both at home and in other Member States. Sciarra therefore makes a strong plea for comparative research with a view to enhancing our understanding of how governance of labour relations works in different Member States and the extent to which we may expect to find convergence or divergence. The research agenda that she suggests goes well beyond a positive analysis of how institutions in the various Member States operate today. Rather it calls for probing into the normative preconditions for the possible convergence of labour standards.

Catherine Barnard's contribution documents precisely how important research into actual governance structures might be in this connection. Focusing on the United Kingdom example, and using empirical, mostly interview-based, data to assess the impact of the working time directive on labour relations in the UK, she finds that the UK simply lacks the relevant institutional underpinning to fully meet the expectations of the directive. She also documents how employers and labour have contracted out of the directive, using precisely the exemptions for which the UK had bargained. The evidence offers a rare insight into the constraints that the social actors face on the ground and from which European law makers and their general policy objectives often seem quite removed. Some of these examples may appear rather mundane, such as the logistical problems involved when hiring additional labour in order to comply with the working time directive, including finding locker and parking space for them. Yet, the importance of these issues should not be underestimated, as they translate into real economic costs. In addition, the prominence these issues had in the responses collected from employees as well as employers reveals that the underlying normative connotations of the working time directive have little resonance in the UK, or put differently, that economic cost considerations seem to outweigh social aspirations.

At the same time, the data shed light on the possible limitations of flexible governance devices as instruments for the shaping of labour governance. Flexibility may create room for experimentation, but it may create opportunities to opt out. It may also give rise to uncertainties as to how other social actors will behave, thereby undermining the willingness on the part of some to adhere to stricter standards.

Csilla Kollonay Lehoczky contrasts the objectives of (and the assumptions underlying) the EU governance model of labour relations with the actual experience of the new Member States that share a socialist past. She observes that the socialist legacy has given rise to a backlash against labour regulation. Where once labour rights were promoted officially, albeit imperfectly, they have now been made largely subject to market forces as the remedy for all economic and social ills. Labour welfare in fact appears to be one of the big losers in the transition process, as evidenced by very substantial unemployment rates in these countries. An increasingly urgent need is felt to address not only unemployment, but also the governance of labour relations, so as to avoid Manchester-style capitalism in 21st-century Central Europe.

And yet the European governance model may not be a good fit, as these countries lack the social actors, in the form of employer representatives and labour unions, on which the operation of that model rests. This is the case, to a large extent, because labour unions and strong workers' rights were discredited when the socialist regime collapsed. Many of the protective devices introduced by the *acquis* allude to aspects of this past regime, which distracts from the fact that the changed economic and political environment has given these principles very different meaning. Effective labour governance in the new Member States will thus depend on the ability of these countries to lend renewed credibility to the idea of labour protection and to support the establishment of new governance mechanisms capable of living up to the demands of a social and market economy.

CORPORATE GOVERNANCE

Harmonisation of corporate law has long been one of the primary goals of European law making, the essential idea being to create a level playing field for companies from the different Member States prior to committing to freedom of establishment of firms and the free movement of capital. Of course, many company law directives were developed at a time when European policy making followed the traditional, or classic, governance model. However, as this model's appeal waned in the wake of the difficulties and delays resulting from differences among Member States on the proper goal and techniques of European regulation, greater flexibility has also found its way into company law legislation at the EU level.

In their contribution, Peter Doralt and Susanne Kalss document the evolution of the EU's company law directives. They also show how the EU has gone through a similar process with regard to creating a governance structure for European financial markets. Both in the company law and financial services cases, harmonisation was used as an instrument for market integration, and yet national interests often dictated that harmonisation remained partial.

The European Court of Justice, however, has increasingly challenged this strategy, giving direct effect to the relevant free movement principles in the EC Treaty even on matters where harmonisation efforts had faltered or were lacking. The legal framework for regulating corporate governance thus exhibits considerable tension between the commitment to free movement, on the one hand, and attempts to maintain existing protections of various stakeholders of the firm (not only shareholders, but creditors and labour as well), on the other.

In recent years, law making in the area of corporate governance has increasingly taken a more flexible approach. This is particularly true in the area of financial market regulation, where the very pace of market development calls for frequent changes in rule making. Doralt and Kalss document how the EU is moving towards a system of harmonising only the broad principles and leaving the details of implementing regulations to committees composed of national regulators, and ultimately to the Member State governments. They suggest that basic harmonisation is demanded by transaction cost considerations, but laud the greater flexibility Member States have under the new approach, which in their view will give rise to greater regulatory competition.

According to Stanislaw Soltysinski, the imposition of the EU's corporate governance structure has been more beneficial than costly for the new Member States. The adoption of the *acquis* has been costly in forcing the acceding Member States to adopt and implement numerous new pieces of legislation irrespective of their likely priority at home. Yet, at least in the area of corporate law and financial market regulation, existing European law has not superimposed a rigid structure, but rather has offered these countries an ample menu of legal rules from which to choose in developing their own governance structures. Despite the much greater emphasis on harmonisation in corporate than in labour law, the harmonisation of corporate law in Europe has remained partial. Thus, many crucial decisions are left to the Member States, including the accession countries, which in making their choices have relied primarily on other European models. This may have been dictated in part by the prospect of accession and the mandate to comply with the *acquis communautaire*. However, as Soltysinski explains, historical ties to the legal system of particular Member States — in the case of Poland, ties to the German system — may have been more important. Still, the European harmonisation project seems to have accelerated the process of legal adaptation in core areas and has certainly supported the transfer of legal know-how and expertise in the form of technical and financial assistance.

Erik Berglöf and Anete Pajuste use economic data to document the emerging governance structure of firms in transition economies. Across transition economies, they identify a strong trend toward ownership concentration, a trend that appears to operate independently of the privatization

method these countries have pursued at an earlier time. Herein lies an important lesson for advocates of smart institutional design. Even countries (such as, among the new Member States, the Czech Republic, Slovenia, Lithuania and Latvia) that have employed mass privatization strategies in an attempt to create firms with widely dispersed shares which could then be traded on stock exchanges have witnessed a strong trend towards ownership concentration. Against this factual background, Berglöf and Pajuste critically assess a number of EU directives, among them the mandatory bid rule in the new takeover directive. They suggest that this rule reinforces the trend towards concentration of ownership, as it forces an acquirer of a critical stake in a company to extend the offer to all other shareholders. This is an important lesson on the likely effect of rules that seek to address a particular problem — the fair treatment of all shareholders in a corporate acquisition — but that may have adverse consequences from a societal point of view, as excessive concentration of ownership may not be desirable. The precise impact of the mandatory takeover rule on ownership concentration may be difficult to ascertain. Still, the empirical evidence presented in this paper shows just how important it is to take into account the existing conditions in different Member States when assessing the costs and benefits of legal design.

Katharina Pistor's analysis of the likely impact of the *acquis* in the new Member States departs from the empirical observation that the former socialist countries face particular and distinctive governance problems, notably balancing protection of minority shareholders against blockholders, organising governance of partially state-owned firms, and ensuring adequate law enforcement. Despite the fact that most firms in the current Member States share an ownership structure similar to those in these acceding states — a structure characterised by stakes highly concentrated in a few owners — the *acquis communautaire* simply does not effectively address the principal/agency problems that this ownership structure generates. With regard to law enforcement, she notes that transition economies suffer from weak enforcement institutions. Firms from these countries might therefore benefit from piggy-backing on superior institutions in other countries, for example by cross-listing on foreign stock exchanges. The EU's strong commitment to home country regulation, however, denies them this opportunity, as existing rules provide that even if they cross-list, regulators back home will remain in charge. In other areas, however, European law has established important new guidelines for addressing problems prevalent in transition economies. The ECJ's rulings on golden shares, for example, have established governance principles for partially state-owned firms that hold important lessons for the new Member States, including the lesson that once firms have decided to reap the benefits of privatization, their governance is better left to market forces rather than to arbitrary state intervention.

DOMESTIC INSTITUTION BUILDING IN THE SHADOW OF THE *ACQUIS*

The contributors to the last part of this book illuminate the costs and benefits that acceding states will bear and enjoy, respectively, in becoming part of the EU and, among other things, implementing the *acquis communautaire*. The EU's dominant role in shaping domestic policies in these countries over the past years has been at the center of this debate, and it has raised a range of concerns.

One set of concerns are essentially of a national constitutional order. How will membership affect domestic institution-building in those accession states in which democratic and constitutional processes and institutions have only recently been installed, and will it only introduce a dangerous democratic deficit? The other set of concerns is of an essentially sub-constitutional, but no less important nature. As stated at the outset of this Introduction, the *acquis communautaire* is meant to be implemented in a consistent and effective fashion throughout the EU, and its architects at the EU level know that they are radically dependent on national and sub-national authorities for ensuring that, as well as for 'obeying', so to speak, EU law themselves. Compliance is and always has been a problem in the EU and enlargement surely will not lessen it.

The impact of accession on constitutionalism in the accession states is the focus of the chapters by both Miroslaw Wyrzykowski, focusing on Poland, and Andras Sajo, canvassing the accession states more generally. The Polish example shows that accession posed a range of issues from the theoretical (to what extent should the Polish citizenry understand accession to entail a real transfer of sovereignty?) to the seemingly technical (shall accession be accomplished nationally by statute or by referendum?). And what about an apparent conflict between the terms of the Polish Constitution and the mandates of EU law? Fortunately, most of the textual conflicts that Wyrzykowski reports — such as vesting in Polish nationals the right to vote at local levels of government or making Polish nationality a condition for receipt of certain social benefits — appear to be either avoidable through a permissibly EU law-friendly construction of the relevant Polish constitutional provision or readily amendable to bring them into textual conformity. But the Polish case suggests that the remedy may not be so easy when a clash of deep cultural values arises, as in the case of predictable EU law claims that free movement of services entails a right to perform abortions in Poland or right to access by Polish nationals to abortion services in another Member State, or that same-sex marriages performed in other Member States should be entitled to recognition in Poland. It would be a mistake, in the context of enlargement, to assume that national courts or populations will uniformly accede to the notion that the scope of these claims is ultimately to be determined as a matter of EU rather than fundamental national law.

András Sajó's chapter reveals that the domestic constitutional challenges may be even more profound. Even while detailing the scrupulous efforts in various accession states to bring their constitutional arrangements into line with the requirements of EU membership, he shows that serious issues persist. Ominously, Sajó wonders whether the processes by which membership was decided upon and negotiated in the accession states were sufficiently consultative and otherwise democratically legitimated, considering the high stakes, and whether that could backfire 'in the event that tyrannical or corrupt elites should ever attempt to govern.' Like Wyrzykowski in the case of Poland, Sajó even reports an ambivalence among national populations about having surrendered their recent and hard-won self-determination to an EU master. Even if those misgivings are overcome, the fact remains that EU membership is having a discernible impact on certain recent and still prized constitutional norms in several accession states — norms like the separation of powers, which may be threatened by the marginalisation of national parliaments in EU affairs.

Similarly, even though fundamental EU constitutional principles such as the supremacy of EU law may come to be accepted, even textually, in national constitutional law, the willingness of national supreme and constitutional courts to yield to the European Court of Justice on fundamental questions remains to be gauged. The problem is not a new one or in any sense unique to the new Member States. But the robustness of judicial review by national constitutional courts among the states of Central and Eastern Europe is not, as Sajó reminds us, to be underestimated.

While Sajó and Wyrzykowski examine the broad impact of EU membership on pre-existing constitutionalism at the accession state level, Member States also have a role in implementing EU constitutional norms. One such norm, having special resonance in certain accession states and presenting special compliance risks, is protection of minority rights. In examining the understanding of those rights — and the larger principle of non-discrimination which minority protection can both advance and potentially contradict — within the accession states, Antje Wiener and Guido Schwellnus bring enforcement and compliance issues into the picture. In so doing, they demonstrate that the effectiveness of EU constitutional norms within Member States depends both on the interpretation and understanding of norms, on the one hand, and enforcement of those norms, once interpreted and understood, on the other. Comparing these processes in some detail among two accession states (Hungary and Poland) and a near-future accession state (Romania), both in relation to minority rights and non-discrimination, the authors reveal the range of patterns of understanding and compliance that we may expect to encounter in such situations. As is the case with so many other chapters in this volume, the processes examined prove to be less than smooth, marked by what the authors describe as 'contestation' and occasionally producing a form of what they call 'backlash'.

Finally, Roland Bieber and Micaela Vaerini, treating implementation and compliance as in itself a matter of core concern to the EU and to those who pin any hopes on EU law or policy, systematically survey the available strategies for improvement in these respects. The authors interestingly observe that, while enlargement may heighten the difficulties that the EU faces on these scores, the accession process leading to that enlargement has caused the EU to experiment with a whole new range of techniques for fostering implementation and compliance, running the gamut from 'soft' to 'coercive', and for measuring the extent to which those techniques have yielded positive results. What emerges is a taxonomy of instruments whose diversity is owed more to the accession phenomenon than anything else, but whose efficacy stands to be most severely tested in the accession states themselves. They conclude with an assessment of the risks associated, precisely in this context, with the empiricism and experimentalism that has characterised the development of these new strategies. For anyone interested in law 'on the ground' in accession, as well as existing, Member States, the inquiry is fundamental.

Such is the enterprise underlying this book. It is daunting for the EU, which aspires to a polity but is still evidently 'a work in progress,' to integrate such a large number of new states at the same time as those states themselves are modernising in ways unrelated to EU membership. That a wide range of institutional complications at both the EU and Member State level should arise at a moment like that can hardly occasion surprise. Nor can the fact that enlargement will problematise the making and implementation of substantive policy, of which we have taken labour and social policy, on the one hand, and corporate governance, on the other, as prime examples. While we believe that the difficulties will prove far from insuperable, we also believe that properly anticipating those difficulties can help us both to adjust our expectations and to prefer institutional arrangements and substantive approaches that will tend to minimise them.

Part I

The Legal Foundations of the Enlarged European Union

1

Institutional Settlements for an Enlarged European Union

INGOLF PERNICE

INTRODUCTION

THE PROCESS OF constitution making in the European Union is reaching a critical stage.[1] After almost one and a half years of intensive work of the Constitutional Convention and of European-wide debate, the President of the Convention, Valéry Giscard d'Estaing submitted to the President of the European Council on 18 July 2003 a 'Draft Treaty establishing a Constitution for Europe.' Accession treaties for the 10 candidate countries[2] were signed on 16 April 2003 in Athens, and all referenda constitutionally necessary in the candidate countries for enlargement to occur have been passed. An Intergovernmental Conference (IGC) to consider and adopt a Constitution was decided upon at the Thessaloniki Summit on 19 and 20 June 2003[3] and began under Italian Presidency in October of that year.

The constitutional debate has raised many important points concerning enlargement's implications for the functioning of the Union. The crucial question has been how to ensure that the institutions will function adequately in a Europe of 25 or more Member States. Neither in Amsterdam nor in Nice did the member states succeed in agreeing upon the necessary substantial reforms; indeed, in this respect, the Treaty of Nice was widely viewed as a complete failure.[4] But the Nice Summit did pave the way for a new

[1] For an excellent analysis of the situation of the debate in February 2003, see K Hughes, 'The Battle for Power in Europe — Will the Convention Get it Right?' in J Beneyto Pérez and I Pernice (eds), *The Government of Europe — Institutional Design for the European Union* (3rd ECLN Conference, Madrid, 2003) <http://www.ecln.net.htm> (13 October 2003).
[2] Available at: 'EU accession treaty: full-text and analysis of key Articles' *Statewatch News Online* <http://www.statewatch.org/news/2003/feb/14accession.htm> (13 October 2003).
[3] 'Presidency Conclusions' (Thessaloniki 19 and 20 June 2003, point 5) <http://europa.eu.int/futurum/documents/other/oth200603_en.pdf.> (13 October 2003).
[4] For critical comments see eg CW Herrmann, 'Common Commercial Policy After Nice: Sisyphus Would Have Done a Better Job' (2002) 39 *CML Rev* 7–29; E Pache and F Schorkopf,

attempt, reflected in the Declaration of Laeken which adopted the then new 'Convention' procedure for addressing the many aspects of constitutional reform of the Union.[5] The work of the Convention culminated in a 'Draft Treaty establishing a Constitution for Europe,' among whose most salient features are important institutional re-arrangements deemed necessary in order for the Union to function in an effective and democratic way. The Intergovernmental Conference was meant to conclude at the Rome Summit in December 2003, with signature of a 'Constitutional Treaty,' according to the Conclusions of the Thessaloniki-Summit in June 2003, 'by the Member States of the enlarged Union as soon as possible after 1 May 2004.'[6]

During the Convention, draft constitutions were submitted by various convention members, as well as by members of the European Parliament, academics and think tanks.[7] All proposed substantial changes to the existing institutional setting of the Union, and certain general trends were able to be identified. Yet, the preliminary draft Constitution issued by the Presidium on 28 October 2002[8] gave no indication of a possible solution. Apart from a 'Discussion Circle' on the European Court of Justice,[9] no specific working group on institutional issues was created. Debate within the Plenum on these issues did not start until spring 2003. Although options were often characterised in terms of a split between federalists and intergovernmentalists, the proposed solutions were varied: a presidential system, preservation of a rotation system at the Council, and team presidencies, as well as options combining elements of the different systems.[10]

The first proposal to come from high political quarters — from Prime Ministers Aznar and Blair and President Chirac — entailed appointing for a period of some years an elder statesman as the President of the European Council, to represent the Union to the outside world while

'Der Vertrag von Nizza — Institutionelle Reform zur Vorbereitung der Erweiterung' (2001) *Neue Juristische Wochenschrift* 1377–86.

[5] 'Laeken Declaration — The Future of the European Union' *The European Union On-Line* (15 December 2001) <http://europa.eu.int/futurum/documents/offtext/doc151201_en.htm> (13 October 2003).

[6] See above n 3.

[7] See the collections available under 'Draft Constitutions' *Walter Hallstein — Institut für Europäisches Verfassungsrecht* <http://www.rewi.hu-berlin.de/WHI/english/index.htm> (13 October 2003) and *C·A·P Startseite* <http://www.cap.uni-muenchen.de/konvent/entwuerfe.htm> (9 March 2004).

[8] See the collections available under 'Draft Constitutions' *Walter Hallstein — Institut für Europäisches Verfassungsrecht* <http://www.rewi.hu-berlin.de/WHI/english/index.htm> (13 October 2003) and <http://www.cap.uni-muenchen.de/konvent/entwuerfe.htm>

[9] Having had two meetings meanwhile, see the agenda: 'Discussion Circle on the Court of Justice' *The European Convention* <http://european-convention.eu.int/doc_register.asp?lang=EN&Content=CERCLEI> (13 October 2003).

[10] An overview of the debate and proposals are given by I Pernice, 'Democratic Leadership in Europe. The European Council and the President of the Union' *Walter Hallstein — Institut für Europäisches Verfassungsrecht* (WHI Paper 1/03) <www.whi-berlin.de/pernice-leadership.htm> (13 October 2003), now in I Pernice and JM Beneyto Perez (eds), *The Government of Europe — Institutional Design for the European Union?* (Nomos, Baden-Baden, 2004) 31.

chairing the European Council.[11] Following strong criticism of this proposal by smaller Member States and expressions of scepticism from Germany, a shift occurred. By the time debate on the institutions began in the Convention's Plenum on 20 January 2003,[12] a Franco-German Elysée-Proposal of 15 January 2003[13] had come to occupy center stage. It combined the idea of a President of the European Council who would be elected by the Heads of State and Government with the German proposal to provide for the election of the President of the Commission by the European Parliament. Although the Presidium's initial draft of 6 February of the first sixteen articles of the Constitutional Treaty did not concretely address the institutions, it did lay down some principles and general provisions of the Union,[14] surrounding which a broad consensus had been reached. It had essentially been agreed:

— to abandon the pillar structure of the Union, while giving the Union legal personality,
— to make the Charter of Fundamental Rights a legally binding instrument and to integrate it into the Constitution,
— to ensure greater continuity in the external representation of the Union, possibly through a Foreign Secretary or Minister,
— to distinguish more clearly the executive from the legislative functions of the Council (the latter to be exercised in co-decision with the European Parliament),
— to make qualified majority voting the general decision making procedure in the Council,
— to strengthen the democratic legitimacy and accountability of the Commission, for example, through the election of its president by the European Parliament,[15] and
— to call the revised Treaty a 'Constitution' of the European Union, or at least a 'constitutional treaty.'

[11] See 'Discours de M. Jacques Chirac' Elysée (Strasbourg, 6 March 2002) <http://www.elysee.fr/> (13 October 2003); Aznar, 'Discurso del Presidente des Consejo Europeo' *St. Anthony's College* (Oxford, 20 May 2002) <http://europa.eu.int/futurum/documents/speech/sp200502_es.pdf > (5 November 2003). See for comments: C Barbier, 'What Project for Europe' *Tomorrow Europe* <http://www.ciginfo.net/demain/files/tomorrow7en.pdf> (13 October 2003).
[12] 'The Summary Report on the Plenary Session' *The European Convention* (Brussels, 27 January 2003) CONV 508/03 of 27 January 2003 <http://register.consilium.eu.int/pdf/en/03/cv00/cv00508en03.pdf> (13 October 2003) (Synthetic Report).
[13] Contribution of Mr. Dominique de Villepain and Mr. Joschka Fischer, members of the Convention, Franco-German contribution to the European Convention concerning the Union's institutional architecture, 'Summary Report on the Plenary Session' The European Convention (Brussels, 27 January 2003) CONV 489/03 of 16 January 2003 <http://register.consilium.eu.int/pdf/en/03/cv00/cv00489en03.pdf> (13 October 2003) (Elysée-Proposals) .
[14] See 'Draft of Arts 1 to 16b of the Constitutional Treaty' *The European Convention* (Brussels, 6 February 2003) CONV 528/03 of 6 February 2003 <http://register.consilium.eu.int/pdf/en/03/cv00/cv00528en03.pdf> (13 October 2003).
[15] Synthetic Report, above n 12.

All of these points finally found a consensus among the members of the Convention. And when the Member States convened in June 2003 at the Thessaloniki Summit, they characterised the Convention's 'Draft Treaty establishing a Constitution for Europe' as 'a good basis for starting in the Intergovernmental Conference.'[16]

The Challenge: A Union of Citizens and States

The institutional work was not, however, completed. Details still required further debate, and difficult compromises remained to be worked out on the basis of the institutional principles that guided the IGC.[17] The basic challenge subsisted: to bring about a simple and more transparent system intelligible to the citizens of the Union; to secure democratic legitimacy of Union decisions and democratic accountability of those who make them, and to ensure the efficient functioning of the system in light of the increase in the number of members of each institution due to the accession of 10 new Member States. This accession entails a qualitative change in the Union on account of the necessity of adapting to the very diverse legal and political cultures and the specific historic experiences that the accession states have undergone.

Among the most difficult challenges has been reconciling the two faces of equality — equality of states versus equality of citizens — within a Union comprising countries having more than 80 million inhabitants and others having no more than several hundred thousand. In an international organisation — which the European Union, though formally based on treaties among states,[18] no longer is — the principle of equality of states would ordinarily prevail. However, the Union is of a different nature, having developed into a full-fledged 'supranational Union', a polity *sui generis*.[19] But to the extent that such a polity is based upon the will of, and is constituted by, its citizens, democratic principles require that all citizens have equal political rights. In light of an emerging multilevel constitutionalism,[20] democratic legitimacy can only be derived from the

[16] See above n 3.
[17] These principles can be found already in 'The Laeken Declaration — The Future of the European Union,' above n 5.
[18] See I Pernice, 'Multilevel Constitutionalism in the European Union' (2002) 27 *ELRev* 511 at 517 *ff*.
[19] For the term see: A von Bogdandy, 'Supranationale Union als neuer Herrschaftstypus: Entstaatlichung und Vergemeinschaftung in staatstheoretischer Perspektive' (1993) 16 *Integration* 210. A masterpiece describing and analysing this process is: JHH Weiler, 'The Transformation of Europe' (1991) 100 *Yale Law Journal* 2405, and particularly at 2410 *ff*; though, in my view, the particularities of the EC system as stated in Case 26/62 *Van Gend & Loos* [1963] ECR 1, are an original feature of the Community as conceptualised by Jean Monnet, Schuman, Hallstein and others.
[20] Above n 18, 514–17; and I Pernice, 'Multilevel Constitutionalism and the Treaty of Amsterdam: European Constitution-making Revisited?' (1999) 36 *CML Rev* 703.

citizenry, acting either directly or through the institutions of their respective countries. Unfortunately, this does not appear as clearly as it should from the existing Treaties, notwithstanding the preambular reference to 'an ever closer union among the peoples of Europe,' mention of the right to vote in municipal elections and elections to the European Parliament for 'every citizen of the Union' (Article 19 ECT), or mention of the importance of political parties at the European level as a means of expression of 'the political will of the citizens of the Union' (Article 191 ECT). The Elysée-Proposal rightly declared Europe to be a 'Union of States, peoples and citizens.'[21] A French member of the Convention put it this way, 'The common theme: the citizens first.'[22] In any event, the Heads of State and Government effectively confirmed by proclaiming, upon signing the Accession treaties in Athens, that 'accession is a new contract among our peoples and not merely a treaty among our states.'[23]

The New Procedural Setting: The Constitutional Convention

As we know from federal systems in general, the principle of equality among both citizens and (federated) states can find various institutional expressions. The greater the number and diversity of the component states, the greater the risk of an unsatisfactory result. The current enlargement of course exposes the Union to unknown difficulties in this respect. As already mentioned, attempts at Amsterdam (1998) and Nice (2000) to prepare the Union for enlargement largely failed. In particular, the complex and confusing rules on weighted votes for qualified majority in the Council introduced by the Treaty of Nice did not meet the challenge of enlargement.[24] Nor is the traditional method under Article 48 TEU for the revision of the Treaty, based on preparatory work by a diplomatic intergovernmental conference any longer an adequate means of tackling constitutional challenges.[25]

[21] Elysée-Proposals, above n 13, 1.
[22] 'Contribution submitted by Mr. Alain Lamassoure, Member of the Convention — Institutional balance' *The European Convention* (Brussels, 23 January 2003) (31.01) CONV 507/03 <http://register.consilium.eu.int/pdf/en/03/cv00/cv00507en03.pdf> (13 October 2003).
[23] See above n 3, quoting from Athens at point 36.
[24] Arts 205 ECT and point 2 of the Declaration (20) on the enlargement of the Union attached to the Treaty of Nice; See above n 4 and P van Nuffel, 'Le traité de Nice' (2001) *Revue du Droit de l'Union Européenne* 329; similarly: D Tsatsos, 'The Treaty of Nice. A failure which can only be remedied by means of an effective and properly implemented post-Nice process' in D Melissas and I Pernice (eds), *Perspectives of the Nice Treaty and the Intergovernmental Conference in 2004* (Nomos, Baden-Baden, 2001) 10 ff.
[25] For critical comments see eg A López Pina, 'Nice — or a reflection upon the difficulties to progress in the European integration under the present iron law of oligarchy' *First ECLN-Conference* (Athens, 2001) <http://www.ecln.net> (14 October 2003); E Brok, 'Die Ergebnisse von Nizza — Eine Sichtweise aus dem Europäischen Parlament' (2001) 24 *Integration* 86–93 at 92–93.

Much hope was placed, therefore, in the capacities of a Constitutional Convention, established in Laeken, consisting of Member State and European parliamentarians (to the level of two-thirds of the convention membership) and representatives of Member States governments and the European Commission (to the level of one-third), with representatives of the accession states included on an equal basis. The Convention's very composition reflected the multilevel structure and the dynamism of the political entity whose constitution was to be designed. The Draft Treaty shows confidence in the Convention method by adopting it in Article IV-7 § 2 as the procedure for future modification of the Constitution.

Requirements of 'Multilevel Constitutionalism'

The European Union is not, and was not supposed to become, a state, much less a Super-State. The original concept, as proposed by Jean Monnet and Robert Schuman, was of a new non-state form of political organisation operating as a safeguard of peace and welfare in Europe.[26] Nor is it a mere agency of the Member States, as has been argued by Peter Lindseth.[27] Rather, it is a federal system of an original character. The Union and the treaties by which it is constituted are themselves based on the constitutions of its Member States, occasioning incidental amendments in those constitutions so as to establish joint institutions with competencies to meet the objectives specified in the treaties. Thus, these treaties, much like the new Constitution of the Union, remain complementary to the constitutions of the Member States and, like them, an expression of a social contract, as J.H.H. Weiler underlined many years ago.[28] This social contract among the citizens of nations binds them together through a pooling of their sovereignty with a view to meeting common challenges and goals. The new Constitution should accordingly have been conceived of and drafted as laying down the terms of a new and enlarged social contract among the citizens of the old

[26] See I Pernice, 'Walter Hallstein, Erbe und Verpflichtung' (2001) *Walter Hallstein — Institut für Europäisches Verfassungsrecht* (Paper 7/01) <http://www.whi-berlin.de> (14 October 2003).
[27] P Lindseth, 'Democratic legitimacy and the administrative character of supranationalism: the example of the European Community' (1999) 99 *Columbia Law Review* 628.
[28] JHH Weiler, 'We will do. And Hearken Reflections on a Common Constitutional Law of the European Union' in R Bieber and P Widmer (eds), *The European Constitutional Area* (Zurich, Schulthess, 1995) 413, 439. P Häberle, *Europäische Verfassungslehre* (Berlin, Duncker & Humblot, 2001), 157, 180, 217; P Frankenberg, 'The Return of the Contract' (2001) *The King's College Law Journal* 39; E J Mestmäcker, 'Risse im europäischen contrat social' (1997) in Hanns Martin Schleyer-Stiftung (ed), *Hans Martin Schleyer-Preis 1996 and 1997* 54; MP Maduro, 'Europe and the constitution: what if this is as good as it gets' in JHH Weiler and M Wind (eds), *European Constitutionalism beyond the State* (Cambridge, Cambridge University Press, 2003) 74, 76.

and the new Member States who, in doing so, confer on themselves, the status of citizens of the European Union.[29]

If the provisions of the Draft Treaty on institutional reform of the Union are to be assessed in the light of multilevel constitutionalism, they must be examined from the perspective of the citizens, in whose name the members of the Convention, notwithstanding their respective constituencies, have negotiated and subscribed to the Constitution. It also means taking due account of the substantial role that the Member States will continue to play as the political organisations of their respective peoples, defining and defending their particular national interests as they may converge or may diverge from the 'common' European interest as defined through the institutions and procedures of the Union. Without rehearsing the many different institutional approaches and models put forward in the context of the Convention, the following analysis will focus on the provisions of the new Draft Treaty, in light of certain features of the alternative models.

INSTITUTIONAL REORGANISATION OF THE EUROPEAN UNION

When the candidate countries first applied for membership in the European Union, the Union was functioning fairly well, based upon an internal market, prospects for a common currency, certain complementary policies, and the intention to coordinate Member State policies in economic, foreign and home affairs. Even though it was clear that the accession of 10 new Member States would change the Union's character, it is doubtful that anyone expected the EU's constitutional basis to be entirely revised at the same time. Nevertheless, enlargement was an opportunity to acknowledge that the Union is, indeed, a matter of its citizens. By accession, the peoples of the new Member States will become citizens of the Union, while giving the peoples of the other Member States a comparable status in their countries. The institutions of the Union will be common to all the citizens of the Union, whether nationals of old or new Member States, and success of this European 'joint venture' will depend very much on how these institutions are organised.

Among the objectives, in this context, were of course to simplify the constitutional texts as well as the procedures and the institutional framework, to enhance their efficiency, and to make democratically more accountable those who exercise public authority in the name of or pursuant to the policies of the Union.[30] Regarding simplification as such, it would

[29] I Pernice, FC Mayer and S Wernicke, 'Renewing the European Social Contract: The Challenge of Institutional Reform and Enlargement in the Light of Multilevel Constitutionalism' (2001) 12 *King's College Law Journal* 61.
[30] Laeken Declaration, above n 5.

seem difficult to conclude that, having produced a document of 253 pages, divided into four parts, five protocols and three declarations, with two preambles and 465 articles among the four parts, the Convention has dealt with simplification successfully. But a closer look shows that the entire set of constitutional provisions on which the Union would be based would now be contained in a single coherent treaty which systematically proceeds from basic provisions on the Union (Part I) to fundamental rights (Part II), followed by provisions on policies, powers and institutions (Part III), and a last chapter of general and final clauses (Part IV). The Draft Treaty, indeed, looks much more like a Constitution than any earlier European Treaty, especially by merging the three pillars into one Union which is given legal personality (Article I-9) and is bound by the Charter of Fundamental Rights (Part II).

As to the institutions in particular, the focus of debate was decidedly not the European Court of Justice (ECJ). The provisions on the ECJ had already been successfully revised by the Treaty of Nice, though the question of efficient judicial remedies for the protection of the rights laid down in the Charter of Fundamental Rights remained to be resolved.[31] Neither was the focus on the European Central Bank (ECB), although the Draft Treaty would make changes to the provisions on the ECB with a view to simplifying them and ensuring more effective external representation of the Union in monetary, and more particularly exchange rate, policies.[32] Nor would advisory bodies, like the Economic and Social Committee or the Committee of the Regions, undergo substantial changes, even though it might have been desirable to review their utility and efficiency, and in any event better define their functions and possibly reduce drastically the number of their members.

The debate on institutional reform mainly concentrated on the European Council (and the question of the external representation of the Union), the Council of Ministers, the European Parliament and the Commission. At stake is nothing less than the distribution and separation of powers and, indirectly, the tension between national sovereignty and supranational power. In bringing this debate forward to a sound result, the IGC needed to

[31] For some proposals see: I Pernice, 'The Charter of Fundamental Rights in the Constitution of the European Union' (2002) *Walter Hallstein — Institut für Europäisches Verfassungsrecht* (WHI Paper 14/02) <http://www.rewi.hu-berlin.de/WHI/english/index.htm> (14 October 2003) 31–36. Also see 'Final report of Working Group II' *The European Convention* (Brussels, 22 October 2002) CONV 354/02 <www.european-convention.eu.int> (14 October 2003) at 15–16, without any clear conclusions. For a more comprehensive analysis see D Thym, 'Charter of Fundamental Rights: Competition or Consistency of Human Rights Protection in Europe'(2002) *Finish Yearbook of International Law* 11–36. Art III-270 of the Draft Treaty now extends generally the access of the individual to justice in giving it the right of appeal also 'against a regulatory act which is of direct concern to him or her and does not entail implementing measures.'

[32] See for the need of a reform in this respect: S Hölscheidt and C Baldus, 'Bestandsaufnahme und Perspektiven der europäischen Finanzordnung' (1997) *Die Öffentliche Verwaltung* 866–73.

consider what general principles might be found for better defining the functions of each of these institutions within a Union which intends to preserve its specific character as a supranational organisation as opposed to a federal state. Only then could it adequately assess the Draft Treaty's provisions on the role of the citizens, on the concrete powers that each of these political institutions would enjoy, and procedures for ensuring transparency, efficiency and democratic accountability in a system having checks and balances and bearing a proper relationship with the institutions of the Member States. I turn now to these issues.

Basic Principles of the EU Institutional Framework

Three principles seem to have guided discussion of the future institutional framework of the European Union: institutional balance, 'multilevel' complementarity of the centres of action, and the strengthening of the European institutions.

Institutional Balance

There was a consensus (or at least 'political correctness' led to the appearance of a consensus) that the institutional balance of the Union should not be changed or disturbed.[33] Leaving aside the judicial function of the ECJ, checks and balances imply close cooperation among the European Commission, the Council and the European Parliament. The European Council of course sets the EU political agenda by defining the Union's general political guidelines.[34] The Commission, charged with defining and overseeing the common European interest, formulates proposals and takes initiatives on common policies, while overseeing the implementation by Member States of the policies adopted at its initiative by the Council together with the European Parliament. It also executes the budget and represents the Community to the outside world. Thus, the function of the Commission is basically an executive one, except in the areas of intergovernmental pillars two and three, where the Council and, through it, the Member States take the relevant decisions. Finally, the European Parliament exercises overall democratic control both over the behaviour of the Commission and, under the co-decision, the cooperation and the consultative procedures, together with the Council on the legislation of the

[33] K Hughes, above n 1, at 9.
[34] For more details see the Report prepared by the Convention's Secretariat, 'The Functioning of the Institutions' *The European Convention* (Brussels, 10 January 2003) CONV 477/03 of 10 January 2003 <http://register.consilium.eu.int/pdf/en/03/cv00/cv00477en03.pdf>. (14 October 2003).

Union. The Parliament also exercises control through its limited budgetary rights, its enquiries, the ombudsman, and written and oral questions, as well as through public debates on particular political issues.

Admittedly, the meaning of 'institutional balance' is not clear. But we do know that European constitutional law does not follow the pure Montesquieu model of separation of powers. We also know from Article 7 § 1 of the EC Treaty that each of the 'institutions shall act within the limits of the powers conferred upon it by [the] Treaty.' The Court of Justice has specifically used the principle to vindicate the rights of participation of the European Parliament in the legislative process.[35] On the other hand, the separation of powers principle does not cement the allocation of functions and powers, and so it will be difficult to establish whether or not the Draft Treaty seriously calls the institutional balance into question.

'Multilevel' Complementarity

Focusing on the exercise of executive powers at the European level, we observe that the Union does not enjoy any direct enforcement authority whatsoever, which distinguishes it sharply from other federal systems, including federal states. It is true that the Commission may impose fines in the area of antitrust, that the Court of Justice may adjudicate infringements of European law, and that the Council may decide on common actions in the area of the Common Foreign and Security Policy, but there is still no European military, police or judicial enforcement capacity. The exercise of direct force is left entirely to the Member States; only their instrumentalities may give teeth to the policies decided in common at the European level.[36] Unlike the dualistic federalism approach of the United States,[37] this interdependence of the two levels of action gives Europe its specifically multilevel constitutionalism character, allowing competence to make decisions on questions of common interest to be vested at the European level, while the enforcement authority rests with the Member States. Both levels of political action are interdependent and complementary, whereas in the American system, 'each level of government enjoys autonomy within its

[35] Case 138/79 *Roquette Frères v Council* [1980] ECR 3333, at 3359; see for more detail J Shaw, *The Law of the European Union* 3rd edn (Basingstoke, Palgrave, 2000) 238 *ff*.

[36] This can lead to delicate questions concerning the delimitation of responsibilities, see eg Case C–94/00 *Roquette Frères SA*, not yet reported, paras 39–53.

[37] See G Bermann, 'Harmonization and Regulatory Federalism' in I Pernice (ed), *Harmonization of Legislation in Federal Systems. Constitutional, Federal and Subsidiarity Aspects — The European Union and the United States of America Compared* (Nomos, Baden-Baden, 1996) 37, at 40: 'Initially, the American federal system rather explicitly embraced the notion of dual federalism, i.e., the notion that persons are subject concurrently to the prescriptive and enforcement jurisdictions of both federal and state authorities, each acting within its own constitutional sphere'.

designated sphere: neither is dependent on the other for its powers and responsibilities.'[38]

If the specific supranational character of the European Union is to be maintained, and the Union not to develop along the model of a federal state, this fundamental aspect of the vertical division of powers must be preserved, with the result that nations or regions retain a maximum of self-government, while matters of common interest are regulated at the European level. Various provisions of the Draft Treaty confirm or reflect this understanding. Thus, Article I-5 § 1 requires respect for the national identities of the Member States, including for the exercise of 'their essential State functions.' Article I-9 §§ 2 and 3 affirm the principles of 'conferral' and subsidiarity. Article I-36 § 1 obligates the Member States to 'adopt all measures of national law necessary to implement legally binding Union acts.' Article III-307 contemplates that European decisions imposing a pecuniary obligation on persons other than states shall be enforced according to 'the rules of civil procedure in force in the Member State in the territory of which it is carried out.' There is, finally, no provision in the Draft Treaty on European military or police capacities. The monopoly of force remains with the Member States.

Strengthening the European Institutions

A core purpose of the current institutional reform has been to strengthen all the elements of the institutional triangle: the Commission, the Council and the Parliament. Each of them will face specific problems caused or exacerbated by enlargement. These problems are:

- a lack of continuity, coordination, accountability and identity surrounding the European Council and the Council of Ministers,
- a lack of democratic legitimacy of, or efficiency in, a Commission having 25 or more members appointed by the European Council,
- a lack of real political powers and democratic legitimacy in a European Parliament representing 25 or more bodies of nationals, totalling 450 million people, and
- a failure of adequate representation of the Union externally.

The question is how these deficits may be remedied in a way which responds to the aspirations of both the integrationists and the intergovernmentalists in a Union which is based on its Member States still constituting

[38] R Briffault, 'Paradoxes of Federalism' in I Pernice (ed), *Harmonization of Legislation in Federal Systems. Constitutional, Federal and Subsidiarity Aspects — The European Union and the United States of America Compared* (Nomos, Baden-Baden, 1996) 47.

the primary point of attachment and identification of the European citizens. This in turn raises the question of how citizens may come to identify themselves as citizens of the Union and to become aware of their ownership of the Union and its institutions, and how citizens may exercise meaningful rights of participation and control over institutions which must themselves be powerful enough to ensure cohesion and effectiveness.

Equal Status and Political Rights for the Citizen of the Union

I begin with the question of whether the citizen plays any role at all at the European level. More particularly, what is the citizen's status in relation to the institutions and to the constitutional system of the Union more generally? Apart from the definition of citizenship (Article 17 ECT) and of the rights derived from it (Articles 18 to 22 ECT), only Article 191 ECT alludes to that issue, by declaring that political parties at the European level contribute to 'expressing the political will of the citizens of the Union'. Clearly, this was not sufficient to generate civic awareness or European identity, much less active political participation by the citizens of the Union.

The Draft Treaty establishing a Constitution for Europe takes a different course. Through a number of general provisions, it confirms and further develops the status and role of the citizens of the Union. According to Article 1 § 1, 'this Constitution establishes the European Union', 'reflecting the *will of the citizens* and States of Europe to build a common future' (emphasis added). Expanding upon the terms of Article 17 ECT, Article 8 § 2 of the Draft Treaty establishes the citizenship of the Union as a status of equal rights and obligations under the Constitution, and it underlines, apart from the right of free movement, the political rights of the citizens, including not only the 'right to vote and to stand as candidates in elections to the European Parliament and in municipal elections in their Member State of residence,' or the right of petition to the European Parliament, but also the right 'to address the institutions and advisory bodies of the Union in any of the Constitution's languages and to obtain a reply in the same language.' The 'principle of democratic equality', laid down in Article 44 expresses the same idea: 'the Union shall observe the principle of the equality of citizens. All shall receive equal attention from the Union's Institutions.' Article 19 § 2 provides that the European Parliament is elected 'by direct universal suffrage of European citizens', and not merely, as currently provided for in Article 189 ECT, 'consist of representatives of the peoples of the States … .' Further, according to Article 19 § 2, the Parliament represents 'the European citizens' in a way which 'shall be degressively proportional'. Finally, a new Title VI in Part I of the Draft Treaty spells out these principles of representative (Article 45) and participatory democracy (Article 46) in

greater detail, while its Article 46 § 4 even establishes the citizen's right 'to invite the Commission to submit any appropriate proposal on matters where citizens consider that a legal act of the Union is required for the purpose of implementing the Constitution', if 'no less than one million citizens coming from a significant number of Member States' take this initiative.

The European Council and its President

Up to now, the European Council has been composed of the Heads of State or Government of the Member States, their foreign ministers, the President of the Commission and a member of the Commission (Article 4 (2) EU). It has been chaired by the Head of State or Government of the Member State having the Presidency of the Council, with the result that the chair rotates every six months. As Tony Blair made this clear in his Cardiff speech of 28 November 2002,[39] this system, which raises problems today and has done so in the past, will raise even more dramatic problems in a Union of 25 or more Member States:

> The six-monthly rotating Presidency was devised for a Common Market of 6: it is not efficient or representative for a Union of 25 and more. How can a Council with constantly shifting leadership be a good partner for the Commission and Parliament? How can Europe be taken seriously at international Summits if the Chair of the Council is here today, gone tomorrow? The old system has reached its limits. It creates for Europe a weakness of continuity in leadership: a fatal handicap in the development of an effective Common Foreign and Security Policy.

At present, too, Article 18 (1) of the TEU entrusts representation of the Union in foreign and security policy to the Presidency, ie to the foreign minister of the Member State then holding the rotating presidency. The shortness of the six-month period makes it impossible for a presidency even to become operational before the period is over; it is especially difficult to see how a smaller new Member State like the Baltic states, Cyprus or Malta,

[39] T Blair, 'The Future of Europe: Strong, Effective, Democratic' Speech at the Old Library (Cardiff, 18 November 2002) <http://www.number-10.gov.uk> (14 October 2003). For the deficiencies of the rotating system see also: I Pernice and D Thym, 'A New Institutional Balance for European Foreign Policy?' (2002) 7 *European Foreign Affairs Review* 369, at 392–94; W Van de Voorde, 'Rotationsverfahren in der Ratspräsidentschaft der Europäischen Union' (2002) *Integration* 318–24; and S Everts, 'Time to Abolish the EU's Rotating Presidency' 21 *Centre for European Reform* (CER Bulletin, December/January 2001/02) <http://www.cer.org.uk/articles/n_21_everts.html> (5 November 2003) 1.

would cope with the workload and responsibilities of the Presidency in its foreign and security policy aspects. Moreover, in a Union of up to 30 Member States, each state will perform the function of chair or president only once every 15 years.

The solution found by the Draft Treaty represents a compromise between the French-German proposal, on the one hand, and the notion of concentrating the executive functions in the Commission, on the other. The external representation of the Union, would thus be ensured by the President of the European Council, who would be elected by the European Council 'for a term of two and a half years, renewable once', and by a new Minister for Foreign Affairs, who would be a Vice-President of the Commission, appointed by the European Council, acting by qualified majority, with the agreement of the President of the Commission (Article 27 § 1). Article 21 § 2, phrase 2, states that 'The President of the European Council shall at his or her level and in that capacity ensure the external representation of the Union on issues concerning its common foreign and security policy, without prejudice to the responsibilities of the Union Minister for Foreign Affairs' to conduct the Union's common foreign and security policy. Viewed against the background of proposals on the Convention table, this solution is pragmatic and progressive, but it may give rise to uncertainties and confusion, and seems to suffer from a lack of democratic accountability.

EU-Presidency: 'Double Head' or 'Double Hatting'

Of the solutions on the Convention table, the Elysée-Proposal of France and Germany attracted the broadest attention, but also great criticism.[40] Essentially, it represented a 'double head' solution, combining, on the one hand, the French vision of a strong President of the European Council, appointed by the Heads of State and Government by qualified majority for a five year, or two and a half year renewable mandate, with, on the other hand, the German desire for a strong President of the Commission elected by a qualified majority vote of the members of the European Parliament. The problems with this proposal and — to the extent the Draft Treaty reflects its terms — with the solution found in the Draft Treaty are that:

— it concentrates a great deal of power in one person coming from one Member State, which the smaller states fear will invariably be a larger Member State;
— contrary to the Convention's aims, it vests these powers without providing adequately for democratic accountability and control;

[40] See above n 12 and 13.

— it ignores the claim of smaller countries to maintain rotation so as to preserve each country's equal rights and bring the Union closer to its citizens;
— it leaves a democratically elected President of the Commission without real political powers, which is difficult to reconcile with its new legitimacy;
— it perpetuates confusion in the external world as to who represents, and may speak for, the European Union.

It is true that the aim to give Europe 'a face' and to ensure continuity in its representation by a President who is democratically accountable would not have been served either by maintaining the rotation system or by constructing team presidencies. But, as the Commission had pointed out, rotating the Presidency of the European Council, as well as the Council, has been an important tool in mobilising the national administrations and in recognising each Member State's commitment to Europe.[41] The Draft Treaty strikes a compromise by ensuring continuity and authority in representation, on the one hand, while maintaining a system of rotation of the Presidency of Council of Ministers (other than that of Foreign Affairs, Article I-23 § 4), on the other. The Foreign Affairs Council will be chaired by the Union Minister for Foreign Affairs (Article I-23 § 2) who will also be the Vice-President of the Commission.

The remaining problem concerns the relationship of the Foreign Minister to the Commission and its President in representing the Union in external matters falling within 'Community' competence, such as trade, development, and environment policies. Under Article I-25 § 1, phrase 4, the Draft Treaty clearly states that, 'with the exception of the common foreign and security policy, and other cases provided for in the Constitution', it is the Commission which 'shall ensure the Union's external representation.' Article III-194 § 2 also acknowledges this potentially confusing split of competencies: 'The Union Minister for Foreign Affairs, for the *field of common foreign and security policy*, and the Commission, for *other fields of external action*, may submit joint proposals to the Council of Ministers.' (emphasis added) How can this splitting of representation be made understood to third countries? Who in fact will represent the Union in matters of overlapping competence? And who will decide conflicts of competence or conflicts in exercises of competence?

I turn now to the relationship between the European Council and the Commission Presidencies. Given the deficiencies of the '*double head*' solution,

[41] European Commission Communication: 'For the European Union — Peace, Freedom and Solidarity' COM (2002) 728 (4 December 2002) s 2.2.2 at 18.

the German minister of foreign affairs,[42] supported by some members of the Convention, had advanced a *'double hat'* proposal.[43] Under this proposal, the President of the Commission would not only be elected by, and accountable to, the European Parliament, but would also chair the European Council and in effect act as its President. The Draft Treaty did not follow this line, although it does not expressly exclude such a solution. While Article 21 § 3 states that 'the President of the European Council may not hold a national mandate,' nothing prevents the President of the Commission from being elected to that office. The advantage would be that this individual would be both democratically elected and also subject to the control of the European Parliament and the Heads of State and Government alike, thus in effect merging at that level the supranational and the intergovernmental elements of the European construction. With a Union President who is both responsible to the citizens and represents the Union's unity externally and internally, there would be no confusion as to who represents the Union and the principles of democracy would be better respected. On the other hand, of course, such a solution would produce a concentration of power in the hands of a single person,[44] and possibly weaken the Council and the Member States, thus altering an institutional balance which the Convention had sought to maintain.

One President for the European Union

My proposal therefore was, and continues to be, that the system of rotating chairs at the European Council be maintained, while the elected President of the Commission serve as 'President of the Union,' vested with power to take the initiative, to make proposals on the general guidelines and external strategies of the Union and, above all, to represent the Union and its unity to the external world as well as to the Union citizenry. This arrangement

[42] 'Fischer fordert EU-'Superpräsidenten' *Der Spiegel* 50/2002 of 07 December 2002 <http://www.spiegel.de/spiegel/vorab/0,1518,226151,00.html> (14 October 2003); see also I Pernice, above n 18, 527–29.

[43] See Contribution presented by P Lequiller, member of the Convention 'A President for Europe' *The European Convention* (Brussels, 7 October 2002) CONV 320/02, CONTRIB 108; see in particular *ibid*, 5, 7, 11: a President 'nominated by the Council and confirmed by the Congress'; 'Contribution by Mr. Andrew Duff and Mr. Lamberto Dini, members of the Convention "A Proposal for a Unified Presidency"' *The European Convention* (Brussels, 31 January 2003) CONV 524/03 of 31 January 2003 <http://register.consilium.eu.int/pdf/en/03/cv00/cv00524en03.pdf> (14 October 2004) 3: 'There should be one President of the Union who would chair both the Commission and the European Council. He or she will be primarily responsible for delivering the decisions of the heads of government and for running the Commission.' With the perspective of joining the presidencies see also Dominique de Villepain, 'L'Union Européenne et la Méditerranée' Marseilles Speech of 2 December 2002 <www.france.diplomatie.fr/actu/article.asp?ART=30071> (14 October 2003).

[44] For a demonstration, see Pernice above n 10 at 6, 17 *ff*.

would also situate the Union's executive function in its rightful place, vis-à-vis the Commission, which has traditionally been the guardian of the Community interest. All of this would reflect the successful institutional logic of the Community, while leaving basic decision making power in the hands of the Member States represented in the European Council. It would also avoid misunderstandings due to the double representation of the Union by the Commission and the Council's Presidency at the international level, while again ensuring that the Member States preserve their final say on the general directions of European policies. Finally, more direct democratic accountability would be established in the person who initiates these policies and represents them *in concreto*, namely a President of the Commission, elected by and accountable to the European Parliament.[45]

The European Minister for Foreign Affairs

Under the proposed arrangement, the role of the European Minister for Foreign Affairs, envisaged in the Draft Treaty, would be clarified. The functions of the Commissioner for External Relations (currently Chris Patten) and those of the Secretary General and High Representative for Common Foreign and Security Policy (CFSP, currently Javier Solana) would effectively be merged into a 'double hatted' individual who would serve as Vice-President of the Commission and act as High Representative at the operational level.[46] Already in Working Group VII of the Convention, a trend had developed to entrust this double function to a 'European External Representative,'[47] otherwise referred to as a 'Foreign Secretary'[48] or simply a 'Minister for Foreign Affairs.'[49] This merger, no doubt, would help ensure greater coherence between the common external policies of the Union (trade, environment, development) and the intergovernmental cooperation in CFSP, and was therefore favoured by the Elysée-Proposal and by many members of the Convention. It is the institutional expression of an 'integrated approach' in foreign and, particularly in security policies, where internal and external aspects could not any longer be separated from each other.

[45] For more arguments: Pernice, above n 10, 18 *ff*.
[46] A number of Members of the Convention seem to favour this proposal, see Synthetic Report on the Plenary of 20/21 January 2003, above, n 12, point 10; see also the 'Final Report of Working Group VII on "External Action" *The European Convention* (Brussels, 16 December 2002) CONV 459/02 <http://register.consilium.eu.int/pdf/en/02/cv00/00459en2.pdf> (14 October 2003) paras 5, 33 and 34. This is a proposition also made in the 'Elysée-Proposals' above n 13.
[47] 'Final Report of Working Group VII on "External Action"' *ibid*, para 38.
[48] The term 'European Secretary for Foreign Affairs' has been suggested by I Pernice and D Thym, above n 39, 394 *ff*.
[49] This is the term used by the 'Elysée-Proposal' above n 13, points 4 and 5.

However, the double loyalty of the Foreign Minister, as that position is envisaged in the Draft Treaty, might prove problematic: The Foreign Minister would be appointed by the European Council only, with the 'agreement of the President of the Commission.' According to Article I-26 § 2, phrase 3, 'the President and the persons … nominated for membership of the College, including the future Union Minister for Foreign Affairs … shall be submitted collectively to a vote of approval by the European Parliament.' Though the Foreign Minister would be a member of the Commission, Article 27 § 1 empowers the European Council to end his or her tenure through the same procedure as is provided for his or her nomination. Would the President of the Commission, then, have the right to request the Foreign Minister's resignation as the Commission President may with regard to the other Commissioners under Article 26 § 3, last phrase? Since he or she would be responsible within the Commission for handling external relations and coordinating other aspects of the Union's external action through Commission procedures under Article I-27 § 3, would it be possible to separate this role from his or her functions regarding, more specifically, foreign, security and defence policies? A better solution would seem to be to fully integrate the Foreign Minister into the Commission, permitting him or her to act under the responsibility of the President of the Commission in the latter's capacity, as proposed, of the President of the Union. Following this logic, the Foreign Minister would not, of course, chair the Foreign Affairs Council, but rather would bear responsibility for proposing and implementing the decisions taken by this Council.

The Council of Ministers Reorganised: A Chamber of States?

The Council serves a decisive function, both in enacting Union legislation under the classical 'Community-method' and in conducting intergovernmental cooperation and coordination of the Member States in the areas of economic, financial and employment policies, in CFSP and in home affairs. Though important measures were taken at the Seville Summit of June 2002 to enhance the Council's efficiency through a better preparation and a better organisation of its deliberations and conclusions,[50] enlargement creates a need for still more fundamental reform. The key words, again, are: transparency, democratic accountability, efficiency and coherence in the Council's work.[51]

[50] European Council of Sevilla, 21 and 22 June 2002, SN 2002/02, annex 1. See already the letter of Gerhard Schröder and Tony Blair of 25 February 2002 to the Presidency <http://www.bundesregierung.de/dokumente/Artikel/ix_70350.htm> (14 October 2003), asking to reduce the agenda of the European Council to only a few priorities.

[51] This is also the opinion of the European Parliament, see: 'European Parliament resolution on the draft Treaty establishing a Constitution for Europe and the European Parliament's

Transparency and Political Accountability

The Council is where the Member States exercise a 'federal control' over the Union's policies, as opposed to the 'democratic control' exercised by the European Parliament. It is here that the Commission's proposals as to what should be the European interests are checked against the national interests and political and legal cultures of the Member States. At the same time, the ministers in the Council are the channel through which, alongside the European Parliament, the European Union legislation derives its legitimacy. Yet, real democratic control over ministerial debate and decision in the Council is largely frustrated as long as the Council's meetings and deliberations are kept secret and confidential. Absent an idea of the positions that their respective ministers defend in the Council, national parliaments—and more generally the publics of the Member States —are disabled from influencing or supervising the legislation decided upon at the European level, even though this legislation has a more substantial impact on the lives of citizens than national legislation does.

The debates within the Convention broadly acknowledged the need for greater transparency and greater democratic control by the European citizens of their ministers through the opening of all Council meetings to the public, at least insofar as the Council acts in its capacity as a legislative body.[52] Working Group V had voted in this direction and the Elysée-Proposal favoured it. The Draft Treaty now states in Article I-49 § 2, as a part of Title VI on the democratic life of the Union: 'The European Parliament shall meet in public, as shall the Council of Ministers when examining and adopting a legislative proposal.' This would allow the media and the public to follow the debates and decision-making process of the Council and to hold the national ministers responsible for whatever political position and strategy they may adopt within the Council.

Such transparency is much more difficult for the Council to achieve when acting in its capacity as an executive of the Union, and it is, in fact, not provided for by the Draft Treaty. But policies on which decisions are taken pursuant to intergovernmental coordination at the European level basically remain national policies for which the individual governments are directly accountable to their respective parliaments. On the other hand, common

opinion on the convening of the Intergovernmental Conference' of 24 September 2003 <http://www.europarl.eu.int/meetdocs/committees/afco/20031021/20031021.htm> (5 November 2003), esp paras 16, 18.

[52] See the 'Synthetic Report' on the Plenary of 20/21 January 2003, above n 12, point 10. For a critical analysis of the progress made on transparency of the legislative process at the Council see: C Sobotta, *Transparenz in den Rechtsetzungsverfahren der Europäischen Union. Stand und Perspektiven des Gemeinschaftsrechts unter besonderer Berücksichtigung des Grundrechtes auf Zugang zu Informationen* (Nomos, Baden-Baden, 2001) 144–82, 274–77.

strategies, positions, or actions in CFSP, as well as broad guidelines of the economic policies of the Member States and framework decisions on home affairs are negotiated at the Council and do not have direct effect in the Member States. Efficiency considerations may require keeping most of the deliberations of the Council in these areas confidential, and a low level of transparency is indeed typical for intergovernmental cooperation in general.[53] On the other hand, matters like economic and employment guidelines or home affairs are not necessarily the exclusive domain of the executive. Deliberations as to them should in principle be open to the public, not least for the sake of enhancing democratic governance in the European Union and making citizens feel more involved.[54] This can only happen if there is a politicised European discourse which, again, requires that political leaders be identifiable with specific positions and that a European discourse be launched in which civil society has a stake and a voice.[55]

The fact that the Draft Treaty provides, throughout Chapter IV in Part III of the Constitution, for the use of ordinary legislative processes in the area of Freedom, Security and Justice shows that these considerations have prevailed with regard to home affairs. The procedures of coordination and multilateral surveillance in the areas of economic and employment policies, based on broad guidelines to be decided by the Council (Articles III-70 *ff*, III-97 *ff*), however, remain basically unchanged. Only the principles laid down in Articles I-45 III and I-46 § 1-3 of the Draft Treaty give citizens a basis for demanding openness, active participation, public hearings and an open, transparent and regular dialogue by the institutions, on the one hand, with representative associations and civil society, on the other.

Efficacy and Rotation

A Council having 25 or more members and a chair which rotates every six months does not allow for effective and rapid decision making. Not only would the traditional 'tour de table', which gives each Member State delegation the opportunity to express a first opinion on the Commission's most important proposals, take more time than available, but more importantly, the

[53] C Sobotta, above n 52, 217–19, 221 *ff*.
[54] 'European Governance: A White Paper' COM (2001) 428 final (25 July 2001) section II esp at 13–14. For an analysis of this notion see C Joerges, Y Mény and JHH Weiler (eds), *Symposium: Mountain or Molehill? A Critical Appraisal of the Commission White Paper on Governance* (Jean Monnet Working Paper 6/01) <http://www.jeanmonnetprogram.org/papers/01/010601.html> (5 November 2003).
[55] J Habermas, 'Die postnationale Konstellation und die Zukunft der Demokratie' in J Habermas (ed), *Die postnationale Konstellation*, (Frankfurt, Suhrkamp, 1998) 91 at 97–105. For an elaboration of this idea in the context of European Governance see P Steinberg, 'Agencies, Co-Regulations and Comitology — and what about Politics' in C Joerges *et al*, above n 54, 139–52.

processes of mediation among diverse interests and of consensus-finding could become endless and pointless. The possibility of achieving a decision on a priority issue within the period of a single presidency would drastically drop with enlargement. Ultimately, the Council would constitute less a team for consensus-building than a 'state chamber' where decisions are actually voted upon, with Member States actually being outvoted.

At the Convention, two important changes were discussed in connection with the Council. According to one, rotation was to be organised around teams consisting of two smaller and one larger Member State. According to the other, qualified majority would become the rule for decision making in the Council.

Under the team presidency proposal, each team would be in office for at least 18 months, and each would elect a spokesperson to provide the team with a single voice and face,[56] and organise themselves so that each team presidency would have the capacities required for efficient planning and accomplishment of the work of the Council in each of its formations. However, the Convention did not adopt this approach. Article I-23 of the Draft Treaty distinguishes among three Council formations: (a) a Legislative and General Affairs Council having the task of ensuring consistency in the work of the Council (§1); (b) a Foreign Affairs Council, charged, on the basis of strategic guidelines laid down by the European Council, with elaborating the Union's external policies and ensuring their consistency (§2); and (c) other formations that the European Council might establish (§3). While the Foreign Affairs Council would be chaired by the Foreign Minister, the presidency of the other formations would continue to rotate among the Member States for periods of at least a year, according to the rules and modalities to be established by a decision of the European Council (§4). Interestingly, this provision refers to 'equal rotation,' but it binds the European Council nevertheless to take 'into account European political and geographical balance and the diversity of Member States.' Most likely, these latter criteria have regard only to the sequence in which Member States hold the presidency, and not to the length of time during which the presidency would be held. The provision also appears to leave open the possibility for the European Council to differentiate between the presidency of the Legislative and General Affairs Council, on the one hand, and the presidency of other Council formations, on the other, so that they are held by different Member States. This option would begin to approach a sort of 'team presidency.'

The other change relates to the decision making mode in the Council: a requirement of unanimity for decision making in a body of 25 or 30, in

[56] For this see: Bertelsmann (foundation), 'Thinking Enlarged Group, Bridging the Leadership Gap. A Strategy for Improving Political Leadership in the EU' (Gütersloh, Bertelsmann, 2002) 6.

contrast to the original six or today's 15 members, would considerably reduce the chance of decisions being reached at all. The principle of decision making by qualified majority vote (QMV) in the Council, therefore, appears to be a necessity across the board, and Working Group VII of the Convention had indeed favoured a maximum use of QMV even in the framework of CFSP.[57] The Draft Treaty embraces this idea, stating that, 'except where the Constitution provides otherwise, decisions of the Council of Ministers shall be taken by qualified majority' (Article I-22 § 3). On the other hand, the compromise at Nice on how qualified majority was to be calculated might not favour easy or rapid decisions.[58] Disregarding warnings against destroying the compromise at Nice, the Convention opted for a system of double majority vote.[59] When the European Council or the Council takes 'decisions by qualified majority, such a majority shall consist of a majority of Member States, representing at least three fifths of the population of the Union' (Article I-24 § 1). Under Article I-24 § 2, qualified majority shall consist of two thirds of the Member States, representing at least three fifths of the population of the Union, where the decision is not taken on the proposal of the Commission or on the initiative of the Foreign Minister.

While this represents important progress, the fact remains that for decisions of the European Council, the general voting rule remains consensus (Article I-20 § 4), and in a number of policy areas, in particular CFSP (Article III-201 § 1) and CSDP (Article III-210 § 2), unanimity is expressly required. This gives rise to questions. If unanimity will in fact put effectiveness at risk, is it reasonable to require it for policies which are vital to the Member States and which demand rapid and effective action? The notion of national sovereignty apparently continues to exclude the possibility of majority decisions in such matters.[60] Yet, the Union and the Member States have a clear obligation under Articles III-195 *ff*, to conduct a common policy and not to undertake uncoordinated individual action. Under these circumstances, the constraints that unanimous decisions impose may result in blocking any action at all.

However, the Draft Treaty allows changing the legislative procedure system wherever special procedures would ordinarily apply. Article I-24 § 4 states:

> Where the Constitution provides in Part III for European laws and framework laws to be adopted by the Council of Ministers according to a special

[57] Final Report, above n 46, points 43 *ff*.
[58] For strong criticism in this respect see E Brok, above n 25, at 87; H Wallace, 'Stimmen und Stimmungen aus Nizza. Entscheidungen der Regierungskonferenz 2000 zum Rat' (2001) 24 *Integration* 124–32 at 125–27. See also the summary in the Secretariat's paper on The Functioning of the Institutions, above n 34, point 19.
[59] See the 'Synthetic Report' above n 12 at 5 para 11.
[60] Other examples that require unanimity in decision making are: Arts I-17 (flexibility-clause), III-62 § 1 and III-64 (tax harmonisation and other harmonisation not covered by Art III-65), III-175 (European Public Prosecutor) etc.

> legislative procedure, the European Council can adopt, on its own initiative and by unanimity, after a period of consideration of at least six months, a decision allowing for the adoption of such European laws or framework laws according to the ordinary legislative procedure. The European Council shall act after consulting the European Parliament and informing the national Parliaments.

A similar 'passarelle'-clause exists for the area of family law under Article III-170 § 3, second subparagraph.

It is questionable whether or not this solution gives enough flexibility to the Council for effective action. Will the 'passarelle-clauses' really be used by the Council, when the Convention was not able to agree upon qualified majority as a general rule? Yet, the unanimity requirement allows each Member State government to veto any decision on its will, and to block action at the Union level, without even giving reasons or being sure that it is backed by a great majority of the people in the country. A more adequate and democratic solution would be to provide for qualified majority decisions at the Council throughout European policies, while permitting a 'qualified veto' in particularly sensitive areas. 'Qualified veto' would mean that one or more Member States may veto a decision envisaged at the Council, but that this veto would be considered invalid unless it is confirmed, within a specified period, by a two thirds majority of the national parliament.

Following the same logic, regarding the procedure on the revision of the Constitution, the requirement of unanimity would be given up in favour of a mode of highly qualified majority voting which would be combined with a 'constitutional veto'. Vetoing the revision of the Constitution would, then, be subject to a confirmation of the veto in accordance with the requirements under national constitutional law for the revision of the national constitution.

Such procedural safeguards would exclude any abuse of the right of veto, giving the veto a specific democratic legitimacy, while limiting its use to very serious problems for the Member State(s) in question.

Coherence of European Policies

The system of multiple Council formations raises a risk of lack of coordination and coherence among their decisions.[61] For example, tobacco advertising has been prohibited by the Council on consumer affairs, while

[61] See the summary in the Secretariat's paper on The Functioning of the Institutions, above n 34, point 14; also: F Mayer, 'Nationale Regierungsstrukturen und europäische Integration' (2002) 29 *Europäische Grundrechte Zeitschrift* 111 at 112–13.

the Council on agriculture gives tobacco farmers generous financial aid.[62] It was initially thought that the necessary coordination would take place in the Member State capitals, and some Member States have indeed organised their internal procedures accordingly.[63] As for the General Affairs Council, which was meant to coordinate Council activity at the European level, it appears to have lost the capacity to do so effectively. National Ministers for Foreign Affairs tend to be preoccupied with their core function, including coordination of foreign policies within the framework of EFSP. The amount and diversity of policies and legislation on the internal market, agriculture, transport, environment, consumer, social and other specific policies has grown to such an extent that it exceeds the capacities of a minister for foreign affairs in terms, both, of technical substance and workload. All of these policies are, in fact, basically internal, not foreign, policies. Facing these problems, the Seville Summit had already taken certain important steps. It reduced the number of Council 'formations' from 22 to nine, and decided that external relations matters would be discussed in meetings separate from those on general affairs. Some members of Working Group VII of the Convention wanted to go still further in formally separating the 'external' from the 'general' affairs formations of the Council,[64] and strong arguments support the proposal, originally made by Amato, Delors and Dehaene,[65] for reforming the 'Legislative Council' into a body which is permanent in Brussels and composed of a full-time Minister for European Affairs from each Member State.

The Convention did not go that far. Still, the general distinction in Article I-23, already mentioned, between the 'Legislative and General Affairs Council,' in charge of ensuring Council consistency, and the Foreign Affairs Council, responsible, on the basis of strategic guidelines of the European Council, for developing the Union's external policies and ensuring their consistency, is an important device for achieving coherence in legislation and policies. This solution comes very close to a real Chamber of States, whose members are members of the national governments, close to the Prime Minister or Chancellor, and participating regularly in the cabinet

[62] Directive 2001/37/EC of 5 June 2001 of the European Parliament and of the Council of 5 June 2001 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco products [2001] OJ L 194/26, on the one hand, and Commission Regulation (EC) 2848/98 of 22 December 1998 laying down detailed rules for the application of Council Regulation (EEC) 2075/92 as regards the premium scheme, production quotas and the specific aid to be granted to producer groups in the raw tobacco sector [1998] OJ L358/17, 0042, on the other.

[63] This seems to be the case for France, see Mayer, above n 61, 119–20, for a more 'flexible' system in Germany *ibid*, 114–17.

[64] Final Report, above n 46, points 6 and 25.

[65] Mayer above n 61, at 122, for this and further references.

meetings of the national government. Each Member State is left to decide who will represent it in this Council, and nothing prevents the minister for foreign affairs from being given this role. But the intention of the new provisions seems to be that the representative of each Member State in the Legislative and General Affairs Council would favour having a central coordinating role for European matters also at the national level. He or she might be regarded as the national 'Minister for European Affairs' and may even be the political head of the permanent representation of the Member State in Brussels, responsible for the coordination of the national positions in the Council. At the same time, the Draft Treaty foresees the possibility of including the ministers in charge of particular policies in meetings of the Legislative and General Affairs Council where appropriate: 'When it acts in its legislative function, … each Member State's representation shall include one or two representatives at ministerial level with relevant expertise, reflecting the business on the agenda of the Council of Ministers' (Article I-23 § 1 subparagraph 3).

It may therefore happen that legislative acts of the Council will be prepared by the specialised working groups and COREPER for discussion in meetings of the specialised national ministers, while the final discussion and adoption are reserved to the Legislative Council where both the Minister of European Affairs and the respective minister in charge of the matter at hand will express the position of their Member State. Ideally, general coherence of European legislation will be ensured through the Ministers of European Affairs, while in each area of action the ministers in charge of the particular legislative area would take the responsibility, before national parliaments and the public, for the substance of the act.

A remaining question concerns coherence between the legislative policies and the action decided upon by the Foreign Affairs Council and those decided upon by any other specialised Council formations which may be created under Article I-23 § 4. Ideally, the 'general political directions and priorities' and the 'strategic guidelines' worked out by the European Council under Articles I-20 § 1 and I-23 § 2/III-194 § 1 and III-196 would provide a general framework and orientation for coherent policies. As to the proposals and policies emanating from the Commission, it would not be the task of the Commission President and the Minister for Foreign Affairs to ensure coherence between European internal and external policies. But, in the final analysis, nothing would relieve the national governments of responsibility for ensuring that their respective positions and policies in the Council and its different formations lead to coherent European policies. Under the control of the respective heads of government, the foreign ministers in each Member State and the ministers for European affairs, if any, would bear a special responsibility in this regard.

The European Parliament: Democratic Legitimacy and Control

What should be the role of the European Parliament in the new constitutional context? It is, of course, the institution which represents the citizens of the Union and forms one of the two pillars of legitimacy. Up to now, the weaknesses of democracy stemmed from a lack of democratic accountability on the part of those who take decisions and an absence of real political choice in the European elections regarding the direction of European policies. We know that the European Council sets the political agenda and holds its important meetings behind closed doors, and that neither the national parliaments, nor the European Parliament, nor the European public has any effective sanction if they find its decisions to be unwise or wrong.

Much the same applies to the Council of Ministers insofar as its meetings remain confidential. Even the situation of the Commission is not much different. Under the existing rules, the President and the Members of the Commission are appointed by the Council and confirmed by the European Parliament. Though the Parliament has some control over Commission policies and action — through written and oral questions and the motion of censure (Article 201 ECT) — its influence is not transparent and does not necessarily reflect political majorities in the European Parliament.

As long as political leadership rests with the Heads of State and Government, and legislation is firmly in the hands of the Ministers meeting in the Council (subject in most cases to parliamentary co-decision), the only channel for effective political control of European policies is through national elections. Yet, based on more than 50 years of European legislation, one can only conclude that 'European' topics are hardly ever an issue in national — or even European — electoral campaigns. Apart from specialised bodies within national parliaments, the importance of European legislation is still ignored by the majority of parliamentarians, even though in many important areas of action the substance of national legislation is largely determined by European directives which are ultimately decided by the Council of Ministers, again under co-decision with Parliament.[66]

The new provisions in the Draft Treaty would ensure that meetings of the Legislative Council will be in public (Article I-49 § 2). They also state that the governments, through which Member States are represented in the European Council and in the Council, are 'themselves accountable to national parliaments, elected by their citizens.' (Article I-45 § 2 phrase 2).

[66] Very often — like in the famous Maastricht-Case of the Federal Constitutional Court in Germany, Entscheidungen des Bundesverfassungsgerichts (BVerfGE) Vol 89, 155 at 173, Jacques Delors is quoted, who argued already in 1992 that 80% of 'economic law' is determined by Community rules, see J Delors, 'Europa im Umbruch. Vom Binnenmarkt zur Europäischen Union' in European Commission (ed), *Europäische Gespräche*, Heft 9 (1992) at 12.

These provisions may partially remedy the democratic legitimacy problem, as should the new provisions in the Protocols on the Role of National Parliaments in the European Union and on the Application of the Principles of Subsidiarity and Proportionality. But national parliaments do not in any event have the capacity, nor are they designed under the national constitutions, to follow effectively and guide the policies conducted by the Council.

The latter is properly the role of the European Parliament. However, the low rates of participation in the European elections show that the European Parliament is not the central player in European politics either. These rates can reasonably be explained by the fact that citizens have difficulty seeing what real political choices are offered to them in these elections. Yet, only if there are real choices, and if votes have a real impact on persons and their policies, will these elections become genuine democratic European exercises.[67] Of course, the fact that Article I-26 of the Draft Treaty provides for the election of the President of the Commission by the European Parliament represents an important step forward in this respect. From now on, European political parties would have to present their respective top candidates, each having a specific political program, and would then be for the President of the Commission, nominated by the European Council and elected by the European Parliament under Article I-26, and with the support and under the control of the European Parliament, to put the proposed policies into effect.

No doubt, the implementation by the Commission of its defined political agenda would on occasion conflict with the positions of national governments represented in the Council, and a real risk of a policy blockage might arise. But the new system of political election of the Commission President and the Council's meeting in public would at least enhance transparency and possibilities for holding accountable those who are responsible for the deadlock. Moreover, the new system presupposes that the Commission will generally have the political support of the majority in the European Parliament, which will in turn exert heightened political pressure on those governments which are hesitant about or oppose the measure in question. Conflicts should then be settled in open and broad political debate, not through unexplained refusals in private meetings.

The European Parliament would also see its powers considerably enhanced under the Draft Treaty, through provisions that make it an equal partner of the Council in legislative and budgetary matters. This would be a

[67] For an elaboration of this idea in the context of European Governance see P Steinberg, 'Agencies, Co-Regulations and Comitology — and what about Politics' in C Joerges, Y Mény and JHH Weiler (eds), *Symposium: Mountain or Molehill? A Critical Appraisal of the Commission White Paper on Governance* (Jean Monnet Working Paper 6/01) <http://www.jeanmonnetprogram.org/papers/01/010601.html> (6 November 2003)139, at 141–45.

major achievement for European democracy. Under Article I-22 § 1, the 'Council of Ministers shall, *jointly with the European Parliament*, enact legislation, exercise the budgetary function and carry out policy-making and coordinating functions' (emphasis added). Co-decision between both institutions would thus become the rule. Article I-33 § 1 requires the 'agreement' of both institutions, in principle, for legislative acts to come into effect. Within the 'limit of the Union's resources,' laid down by the Council with the consent of the Member States (Article I-53 § 3), the powers of the European Parliament would be even greater with respect to the financial provisions and, in particular, the annual budget to be adopted under the special procedure of Article III-310. The Draft Treaty simplifies the budget procedure by abolishing the distinction between necessary and other expenditures and giving the European Parliament ultimate responsibility for the budget.[68] 'Except for such expenditure arising from operations having military or defense implications and cases where the Council of Ministers decides otherwise,' even the operational expenses of CFSP are covered by the annual budget of the Union and determined according to this procedure.

Consideration, however, should be given to conferring on the Union a power of taxation. This would make the Union and, on its behalf, the European Parliament also financially accountable to the citizens. It would install the reverse of a common principle: no representation without taxation.[69] The citizens would then not only decide upon the substance of the Union's policies, but also become more directly aware of and take responsibility for their costs. This should not prevent the Member States from having an important voice in all financial decision making of the Union, for it is their task to implement European legislation and to bear the associated costs. However, the financial co-responsibility of the national governments and parliaments on the one hand, and of the European Parliament, on the other hand, would better reflect the double channel of legitimacy of European policies based on people being national and European citizens at one and the same time.

The European Executive: For a Strong and Democratic Commission

As already indicated, the application and implementation of European legislation is, and should remain, in principle a matter for the Member States. Moreover, in areas of national competence, where the European level does no more than coordinate the policies of the Member States, basic executive functions remain with the national governments. This is the case, in particular,

[68] See, in particular, Art III-310 ss 8 and 9.
[69] See M Schreyer, *Die Europäische Finanzverfassung vor der Erweiterung* (FCE 2/00) <http://www.rewi.hu-berlin.de/WHI/deutsch/fce/fce100/schreyer.htm> (14 October 2003).

with economic and financial policies, even if Community policies like competition, agricultural, regional, budgetary or monetary policies clearly must be properly regarded as 'economic' policies too.[70] It is also true for foreign and security policies, even though the distinction between foreign and internal affairs in security matters is becoming ever more difficult to draw. Indeed, Community policies such as commercial, development and environmental policies should be conducted as components of an 'integrated strategy' in European foreign and security policy.[71] The need for coherence among all these policies militates in favour of a strong role for the Commission in designing and coordinating coherent European action alongside measures decided upon at the national level.

The Commission also has direct executive functions, including the application of competition rules, control of state aids, establishment and execution of the budget, and management of the structural funds. Its right of legislative initiative and its monopoly over submission and defense of proposals before the Council may not be characterised as genuinely executive. But this is what makes the European legislative process run so successfully. Moreover, the Commission's role as a watchdog over the application of European law by the Member States is a necessary condition for the functioning of the Union and represents a typically executive function. Finally, as mentioned above, the Commission has an important advisory and coordinating role to play within the European Council and within the 'executive' Council's handling of economic and financial policies, employment, home affairs and CFSP. All these functions are addressed in Article I-25 § 1 of the Draft Treaty, which adds to the Commission's responsibilities the external representation of the Union, except for CFSP, and underlines the duty of the Commission to 'initiate the Union's annual and multiannual programming with a view to achieving inter-institutional agreements.' It also confirms the Commission's monopoly, in principle, in proposing legislative acts (Article I-25 § 2).

The most important change that the Draft Treaty brings to the Commission is of course the election of its President by the European Parliament. While this would not put an end to the 'neutrality' of the Commission, it would acknowledge the already existing political role of the Commission and allow it to be taken seriously.[72] Also important is the reduction in the number of Members of the Commission from 1 November 2009 onwards. From then on, the Commission would be a 'College comprising the President, the Union Minister of Foreign Affairs/Vice-President, and 13 European

[70] See I Pernice and F Hoffmeister, 'The Division of Economic Powers between the European Community and its Member States — *Status quo* and Proposals *de lege ferenda*' in A von Bogdandy, PC Movroidis and Y Meny (eds), *European Integration and International Co-ordination. Studies in Transnational Economic Law in Honour of Claus-Dieter Ehlermann* (The Hague, Kluwer, 2002) 363 at 364 *ff*.
[71] See I Pernice and D Thym, above n 39.
[72] See also K Hughes, above n 1.

Commissioners selected on the basis of a system of equal rotation between the Member States.' It would then be the task of the Commission President to appoint 'non-voting Commissioners, chosen according to the same criteria as apply for Members of the College and coming from all other Member States.' (Article I-25 § 3). It follows from the wording of the Article, and also from that of Article I-26 § 2 on the appointment procedure for the Commission, that the 'non-voting Commissioners' would not be part of the College, nor is their role defined. Articles III-250 ff consequently distinguish between 'European Commissioner' and 'Commissioner', thus creating a two-class system for membership in the Commission.

The Convention's solution would satisfy the objective of designing an efficient body for the post enlargement era, while taking account of the wish of many Member States to see one of their nationals as a Member of the Commission. However, it falls short of indicating what functions the 'simple' Commissioners may be assigned by the President in exercising his or her power of internal organisation under Article I-26 § 3, 2nd indent, except to establish that only members of the College may be nominated as Vice-President (Article I-26 § 3 3rd indent). It would be difficult to confer on them the functions of a Director General, as they stand today, since this would create an unacceptable hierarchy between the different categories of Commissioners. They might be given a political responsibility over a Directorate General, comparable to that of the 'European Commissioners', but their authority would necessarily be minor due to their having no vote in the Commission. It would appear then that non-voting Commissioners might be assigned responsibility for the more technical functions of the Commission, such as within the Secretariat-General, the Legal Service, or financial control services, or that they might be nominated as heads of various agencies of the Union. They might even be named as a kind of Vice- or 'junior' Commissioner to one of the Members of the College, thus forming 'double head cabinets' so as to ensure full working capacity of the Commission and representation of each Member of the College at all Commission meetings.

The answer to the question of whether such a two-tier system of Commissioners is efficient, or will really satisfy those who have insisted on the principle that each Member State have one of its nationals in the Commission, will depend on how the Commission President chooses to organise 'his' or 'her' Commission. If no satisfactory solution is found, it becomes questionable whether the post of 'simple' Commissioner will be attractive for any ambitious political leader of any Member State.

CONCLUSION

Enlargement of the European Union without substantial changes in its institutional settlement would come close to suicide for the European Union. It

would at least be contrary to the interest of the existing Member States as well as of the accession states. The Draft Treaty on a Constitution for Europe presented by the Constitutional Convention is not an entirely new, but rather a largely and deeply revised, text of the existing treaties, merging them together and giving them the form of what most people could probably accept as a Constitution of the European Union.[73] While still complex and far from providing the citizens with a simple understanding of the powers and the functioning of the Union, it would render the institutional framework more efficient and more democratic, establish a legal personality of the Union, integrate the Charter of Fundamental Rights as binding constitutional law,[74] offer a more systematic and transparent attribution of powers to the Union,[75] and provide for a continuous representation of the Union in external relations. All of these would be important gains.

Even as to more fundamental objectives of the reform — transparency, democratic accountability, efficiency and identity — it is submitted that the Convention has established a number of vital points that were far from fully agreed upon at the time when the Convention opened.[76] However, since important institutional discussions on the draft Constitution go on, certain further improvements should be considered. These include, notably:

— giving the Union a single face by vesting the President of the Commission with the representative and executive powers of a 'President of the Union';
— abandoning decision making by unanimity in the Council generally, and replacing it with qualified majority voting, combined with 'qualified veto', as a safeguard in serious cases of essential need;

[73] For some ideas how such a Treaty should look like, see I Pernice, 'Elements and Structure of the European Constitution' 2nd European Constitutional Law Network Conference <http://www.whi-berlin.de/pernice-structures.htm> (14 October 2003) at 5. The impact the new European Constitution might have upon national Constitutions is analysed by P Steinberg, 'A Tentative Survey of the Innovations of the Constitution for Europe that might Impact Upon National Constitutional Law' in J Ziller (ed), *The Europeanisation of Constitutional Law in the Light of the Constitution for Europe* (Paris, L'Harmattan, 2003) 139.

[74] For proposals in this regard: Pernice, above n 31 at 31–36.

[75] See I Pernice, 'Eine neue Kompetenzordnung für die Europäische Union' Walter Hallstein — Institut für Europäisches Verfassungsrecht Paper 15/02, <http://www.whi-berlin.de/pernice-kompetenzordnung.htm> (14 October 2003); U Leonardy, 'Kompetenzabgrenzung: Zentrales Verfassungsprojekt für die Europäische Union' in PJ Cullen and PA Zervakis (eds), *Der Post-Nizza-Prozess: Auf dem Weg zu einer Europäischen Verfassung?* (Nomos, Baden-Baden, 2001); R Streinz, Die Abgrenzung der Kompetenzen zwischen der Europäischen Union und den Mitgliedstaaten unter besonderer Berücksichtigung der Regionen (2001) *Bayerische Verwaltungsblätter* 481–488; A von Bogdandy and J Bast, 'Die vertikale Kompetenzordnung der Europäischen Union — Rechtsdogmatischer Bestand und verfassungspolitische Reformperspektiven' (2001) 28 *Europäische Grundrechte Zeitschrift* 441–58.

[76] Compare the conclusions in the draft of this paper, as presented at the conference of 4–5 April, 2003 at Columbia Law School in New York City, see <http://www.whi-berlin.de/pernice-institutions.htm> (14 October 2003).

— clarifying the possible role and function of the 'non-voting' Commissioners in their relationship to the 'European Commissioners'; and
— vesting the Union with a power of original taxation, so as to make it financially accountable for its policies vis-à-vis the citizens of the Union.

The ongoing reform will change the Union substantially; the mere fact of enlargement will do so in any event. In order to achieve an adequate solution, great courage is needed both at the IGC and within each of the existing and future Member States. People will have to demonstrate realism, including acceptance of the fact that national sovereignty is a concept of the nineteenth century which, given the experience of two world wars and numerous disastrous conflicts between 'sovereign' states, has not proven capable of establishing peace and the well-being of humanity. We observe, as JHH Weiler has put it,[77] a 'constitutional moment'; at a minimum, we are experiencing constitutional momentum. The members of the Convention felt that they could play a historic role, as shown by the fact that many governments actually sent their responsible ministers to the Convention. Having invested more than a year of their lifetime in this enterprise, members of the Convention were reluctant to miss an opportunity to 'make history.' The success of their work will, finally, depend on how far the Draft Treaty on a Constitution for Europe finds support among the citizens of the Union. As a major improvement of the constitutional basis of European integration, the Draft Treaty indeed deserves that support. It brings the Union closer to its citizens, who still, however, need to be convinced that this Constitution is worth taking ownership of as the Constitution of 'their' common enterprise: an enlarged Union of States *and* citizens.

References

Bermann, G (1996) 'Harmonization and Regulatory Federalism' in I Pernice (ed), *Harmonization of Legislation in Federal Systems. Constitutional, Federal and Subsidiarity Aspects — The European Union and the United States of America Compared* (Nomos, Baden-Baden).

Bertelsmann (foundation), (2002) *Thinking Enlarged Group, Bridging the Leadership Gap: A Strategy for Improving Political Leadership in the EU* (Gütersloh, Bertelsmann).

[77] Please see JHH Weiler in this volume, 'A Constitution for Europe? Some Hard Choices'; see also JHH Weiler, 'A Constitution for Europe? Some Hard Choices' (2002) 40 *Journal of Common Market Studies* 563 at 578.

von Bogdandy, A and Bast, J (2001) 'Die vertikale Kompetenzordnung der Europäischen Union — Rechtsdogmatischer Bestand und verfassungspolitische Reformperspektiven' 28 *Europäische Grundrechte Zeitschrift* 441.

Briffault, G (1996) 'Paradoxes of Federalism' in I Pernice (ed), *Harmonization of Legislation in Federal Systems. Constitutional, Federal and Subsidiarity Aspects - The European Union and the United States of America Compared* (Nomos, Baden-Baden).

Delors, J (1992) 'Europa im Umbruch. Vom Binnenmarkt zur Europäischen Union' in *European Commission* (ed), (Europäische Gespräche, Heft).

Duff, A and Dini, L (2003) 'A Proposal for a Unified Presidency' *The European Convention* (Brussels, 31 January 2003).

Everts, S (2001-2002) 'Time to Abolish the EU's Rotating Presidency' 21 *Centre for European Reform* (CER Bulletin, December/January issue) 1.

Frankenberg, P (2001) 'The Return of the Contract' 12 *King's College Law Journal* 39.

Häberle, P (2001) *Europäische Verfassungslehre* (Nomos, Baden-Baden).

Habermas, J (1998) 'Die postnationale Konstellation und die Zukunft der Demokratie' in J Habermas (ed), *Die postnationale Konstellation* (Frankfurt, Suhrkamp).

Herrmann, CW (2002) 'Common Commercial Policy After Nice: Sisyphus Would Have Done a Better Job' 39 *Common Market Law Review* 7.

Hughes, K (2003) 'The Battle for Power in Europe - Will the Convention Get it Right?' in I Pernice and JM Beneyto Perez (eds), *The Government of Europe – Which Institutional Design for the European Union* (Nomos, Baden-Baden).

Joerges, C, Mény, Y and Weiler, JHH (2001) *Symposium: Mountain or Molehill? A Critical Appraisal of the Commission White Paper on Governance* (Jean Monnet Working Paper 6/01).

Leonardy, U (2001) 'Kompetenzabgrenzung: Zentrales Verfassungsprojekt für die Europäische Union' in PJ Cullen and PA Zervakis (eds), *Der Post-Nizza-Prozess: Auf dem Weg zu einer Europäischen Verfassung?* (Nomos, Baden-Baden).

Lequiller, P (2002) 'A President for Europe', *The European Convention* (Brussels, 7 October 2002).

Lindseth, P (1999) 'Democratic legitimacy and the administrative character of supranationalism: the example of the European Community' 99 *Columbia Law Review* 628.

Maduro, MP (2003) 'Europe and the constitution: what if this is as good as it gets' in JHH Weiler and M Wind (eds), *European Constitutionalism Beyond the State* (Cambridge, Cambridge University Press).

Mayer, F (2002) 'Nationale Regierungsstrukturen und Europäische Integration' *Europäische Grundrechte Zeitschrift* 29.

Mestmäcker, EJ (1997) 'Risse im europäischen contrat social, Hans Martin Schleyer-Preis 1996 amd 1997', Hans Martin Schleyer-Stiftung (ed) 54.

Pache, E and Schorkopf, F (2002) 'Der Vertrag von Nizza - Institutionelle Reform zur Vorbereitung der Erweiterung' *Neue Juristische Wochenschrift* 1377.

Pernice, I (1999) 'Multilevel Constitutionalism and the Treaty of Amsterdam: European Constitution-making Revisited?' 36 *Common Market Law Review* 703.

—— (2001) 'Walter Hallstein, Erbe und Verpflichtung' *Walter Hallstein — Institut für Europäisches Verfassungsrecht* (WHI Paper 7/01).

—— (2002) 'Multilevel Constitutionalism in the European Union' 27 *European Law Review* 511.

—— (2002) 'Eine neue Kompetenzordnung für die Europäische Union' *Walter Hallstein — Institut für Europäisches Verfassungsrecht* (WHI Paper 15/02).

—— (2002) 'The Charter of Fundamental Rights in the Constitution of the European Union' *Walter Hallstein — Institut für Europäisches Verfassungsrecht* (WHI Paper 14/02).

—— (2003) 'Democratic Leadership in Europe. The European Council and the President of the Union' *Walter Hallstein — Institut für Europäisches Verfassungsrecht* (WHI Paper 1/03) and in I Pernice and JM Beneyto Perez (eds), *The Government of Europe — Which Institutional Design for the European Union*? (Nomos, Baden-Baden).

Pernice, I and Hoffmeister, F (2002) 'The Division of Economic Powers between the European Community and its Member States — Status quo and Proposals de lege ferenda' in A von Bogdandy, P Movroidis and Y Meny (eds), *European Integration and International Co-ordination. Studies in Transnational Economic Law in Honour of Claus-Dieter Ehlermann* (Berlin, Springer).

Pernice, I, Mayer, F and Wernicke, S (2001) 'Renewing the European Social Contract: The Challenge of Institutional Reform and Enlargement in the Light of Multilevel Constitutionalism' 12 *King's College Law Journal* 61.

Pernice, I and Thym, D (2002) 'A New Institutional Balance for European Foreign Policy?' 7 *European Foreign Affairs Review* 369.

Shaw, J (2000) *The Law of the European Union* 3rd edn (Basingstoke, Palgave).

Sobotta, C (2001) *Transparenz in den Rechtsetzungsverfahren der Europäischen Union. Stand und Perspektiven des Gemeinschaftsrechts unter besonderer Berücksichtigung des Grundrechtes auf Zugang zu Informationen* (Nomos, Baden-Baden).

Steinberg, P (2003) 'A Tentative Survey of the Innovations of the Constitution for Europe that might Impact Upon National Constitutional Law' in J Ziller (ed), *The Europeanisation of Constitutional Law in the Light of the Constitution for Europe* (Paris, L'Harmattan).

—— (2001) 'Agencies, Co-Regulations and Comitology—and what about Politics' in C Joerges, Y Mény and JHH Weiler (eds), *Symposium: Mountain*

or Molehill? A Critical Appraisal of the Commission White Paper on Governance (Jean Monnet Working Paper 6).

Streinz, R (2001) 'Die Abgrenzung der Kompetenzen zwischen der Europäischen Union und den Mitgliedstaaten unter besonderer Berücksichtigung der Regionen' in *Bayerische Verwaltungsblätter.*

Thym, D (2002) 'The Charter of Fundamental Rights in the Constitution of the European Union' in M Koskenniemi (ed), *Charter of Fundamental Rights: Competition or Consistency of Human Rights Protection in Europe, Finish Yearbook of International Law XI* (The Hague, Kluwer).

Tsatsos, D (2001) 'The Treaty of Nice. A failure which can only be remedied by means of an effective and properly implemented post-Nice process' in D Melissas and I Pernice (eds), *Perspectives of the Nice Treaty and the Intergovernmental Conference in 2004* (Nomos, Baden-Baden).

van de Voorde, W (2002) 'Rotationsverfahren in der Ratspräsidentschaft der Europäischen Union' *Integration* 318.

Wallace, H (2001) 'Stimmen und Stimmungen aus Nizza. Entscheidungen der Regierungskonferenz 2000 zum Rat' *Integration* 124.

Weiler, JHH (2002) 'A Constitution for Europe? Some Hard Choices' 40 *Journal of Common Market Studies* 563.

—— (1995) 'We will do. And Hearken Reflections on a Common Constitutional Law of the European Union' in R Bieber and P Widmer (eds), *The European Constitutional Area* (Zurich, Schulthess).

—— (1991) 'The Transformation of Europe' 100 *Yale Law Journal* 2405.

2

*A Constitution for Europe? Some Hard Choices**

JOSEPH WEILER

HARD CHOICES

WHO REMEMBERS THE Draft Constitution prepared by the European Parliament in the follow up to the Maastricht Treaty? Even its promoters were quick to consign it to oblivion since, at that time, it spelt political death. To speak of a constitution for Europe was to be tainted with the F word — to be branded as an old fashioned Federalist. Ten years later, there is a political and intellectual stampede to embrace the idea of a constitution for Europe. Joschka and Jacques and Valery and Helmut have all waded in and given the idea political respectability.[1] Habermas[2] has 'koshered the reptile' in intellectual circles. Though the Convention on the Future of Europe was not officially a Constitutional Convention, it was dubbed by its very President as the European Philadelphia, and it has indeed produced a Constitutional document for European public opinion and for the Intergovernmental Conference opened in October 2003. The taxonomy is interesting: from Constitution to Constitutional Treaty and now Treaty establishing a Constitution. The idea of a constitution has lost at least in part that progressive-integrationist connotation. Indeed, Euro-sceptics may be

* An earlier version was part of the 40th anniversary edition of JCMS. This version in much changed especially in dealing with the 'pure' constitutional issue.

[1] Fischer set the ball rolling. For text and discussion See C Joerges and Y Meny in JHH Weiler (eds), *What Kind of Constitution for What Kind of Polity? Responses to Joschka Fischer* (Cambridge, MA, Robert Schumann Centre EUI/ Florence/Harvard Law School, 2000); See too V Giscard d'Estaing and H Schmidt, 'Time to slow down and consolidate around "Euro-Europe" ' *International Herald Tribune* (11 April 2000).

[2] J Habermas, 'Citoyenneté et identité nationale. Réflexions sur l'avenur de l'Europe' in J Lenoble and N Dewandre (eds) *L'Europe au Soir du Siècle: Identité et Démocratie* (Paris, Esprit, 1992); J Habermas 'The European Nation-State and the Pressures of Globalization', (1999) 235 *New Left Review*; J Habermas, '*So, Why Does Europe Need a Constitution?*' (Florence, European University Institute, 2001).

willing to embrace constitutionalism as a means (perhaps even a last ditch stand) for arresting the march of integration. There are many possible explanations for both the reasons and the significance of this change in mood and political discourse.

Let us leave it to historians and social scientists to explore the reasons. But the significance of the change should be a matter of public discussion. The turn to constitutionalism is often tied to the project of enlargement. Institutionally, it is said, Europe is in need of a major overhaul. Under its bonnet, after all, despite endless paint jobs, the same old Commission-Council-Parliament engine circa 1951 or 1957 still rattles on and risks imploding under the additional weight of 10 new Member States. The institutional architecture requires, so the emerging consensus seems to suggest, a constitutional structure. There is, of course, no consensus on the content of that structure, which is seemingly one of the strengths of the constitutional option.

The hardest and most consequential constitutional decision seems to have been taken, and taken in typical European fashion: *deus ex machina*. There is something, indeed more than one thing, deceptive in the juxtaposition of enlargement and Constitution. First is the notion that these two concepts are conceptually different — as if the decision on enlargement was not a constitutional decision. The opposite is true. The enlargement decision was the single most important constitutional decision taken in the last decade, and arguably longer. For good or for bad, the change in number of Member States, in the size of Europe's population, in its geography and topography, and in its cultural and political mix are all on a scale of magnitude which will make the new Europe a very, very different polity, independently of any constitutional structure adopted.

A second deceptive aspect is the notion that, whereas enlargement just happens, the Constitution merits a very special decisional procedure — hence a Convention.[3] Descriptively, enlargement did just 'happen.' There was no serious public debate either at European or Member State level — unless a discussion at the European Council counts as serious public discussion. The consequences, political and economic, have not been transparently set out, and the process of negotiation itself is the European equivalent to the American 'fast track': The Commission negotiates and then presents a de-facto 'take-it-or-leave-it' package. Normatively, there is something deeply ironic in the fact that whatever constitution eventually is born from this process, it will have been the result of this original sin.

This is not to call into question the wisdom of enlargement per se, though the non-transparent decisional process may seriously be critiqued. Likewise, the methodology for enlargement may be questioned. Does it

[3] There are, of course, other reasons as well for adopting the Convention methodology.

really make sense to integrate 10 new Member States all at once (and how did that hugely consequential decision come about)? Does it make sense to premise enlargement on the basis of a monolithic polity, or would any of the 'concentric circle' models in circulation have made more political sense? These issues and others like them are as grave as any that were up for discussion in the constitutional debate. Indeed, in some sense they are primordial, since they will condition the constitutional debate.

Most attention has been focused on the political issues — on, for example, whether the new Europe should see a significant strengthening of the Council or a reinvention of the Commission. Here, instead, are some of the fundamental constitutional issues which underlay the debates of the Convention on a future enlarged Europe. Particularly worth highlighting are those constitutional issues which risk, like the question of enlargement itself, being decided almost by default. The issues are fundamental. Fundamental, too, should be the process of deliberation over them.

THE PURE CONSTITUTIONAL ISSUE: TREATY MASQUERADING AS CONSTITUTION OR CONSTITUTION MASQUERADING AS TREATY?

What is the 'pure' constitutional issue? By this I mean the question that goes to the formal status of the Constitution, independently of its content. The formal status might appear to be just that — an issue devoid of real political or social significance. In fact, this is one of the most consequential decisions Europe will take. The Convention draft at the time of writing is exquisitely ambiguous. Officially, we have a draft Treaty Establishing a Constitution which was submitted to the European Council as a basis for a classic Intergovernmental Conference. But the text itself thinks of itself as a constitution. In the Preamble we find the endearingly self-congratulatory phrase:

> Grateful to the members of the European Convention for having prepared this Constitution on behalf of the citizens and States of Europe

What is behind this ambivalence? The basic options seem to be two.

Imagine that the discussion of content reaches some finality, ie agreement on the shape of the new institutions, on new competences, human rights and all the rest. Imagine further that these new arrangements are redacted into a document of suitable length, in suitable constitutional language. But this could be the outcome of any IGC. This 'constitutional' document could still be signed by its 'High Contracting Parties' and sent for ratification in each of the 25 Member States in accordance with their constitutional requirements, just like any other treaty of significance. In such a

case, Europe would not have a formal Constitution, but a Constitutional Treaty. The obligations included therein would have been assumed by the respective Member States acting as sovereign actors in international law free to undertake obligations, even obligations of a 'constitutional' nature.

What, instead, would be the hallmarks of a 'true' constitution? There could be many, but I would suggest two critical and easily discernable criteria. The first is whether the amendment procedure in the new constitutional document insists on unanimity among the Member States, or whether it allows amendment by some, even if a very privileged, majority. Unanimity, embodying the principle of sovereign equality and consent, is typically a hallmark of internationalism, not constitutionalism. Amendment by majority is not a 'mere' political issue. It is of profound constitutional and social significance. The willingness to submit one's collective self to the discipline of a majority decision making, even at the very high constitutional level, is a sign of a polity, of the intention to associate with *others* on a non-arms length basis. It is an invitation to associate with *others* with the ties of loyalty and commitment which imply subjugation to a newly drawn collective and its will. The material obligation of what is agreed in a treaty or a constitution can be identical. The basis of acceptance and the relationship are radically different.

Draft Article IV-6 on revision is tantalizingly ambiguous. Amendments to the 'Constitution' are envisaged as being adopted unanimously by all Member States in accordance with their respective constitutional requirements. But a little gap is left open as regards the very 'Treaty' establishing the Constitution. If, two years after the signature of the Treaty, four-fifths of the Member States have ratified it, and one or more have encountered difficulties, the matter does not die. It is referred to the European Council. Later in this chapter I will explore some 'middle positions' in relation to this point and what the European Council might do in such a case.

The second sign of a 'true' constitution concerns the type and measure of popular involvement in the adoption process. Almost any Europe-wide plebiscite (and there can be many models) which calls on a single people of Europe, as such, to approve the new constitution would be of huge legal and political significance, and transformative of current European constitutionalism. It gives a different expression to the same social currency articulated through submission to majoritarian amendment. Approval, instead, by the (plural) peoples of Europe, in their status as national communities, would seem to affirm the constitutional status quo, once again independently of the content of the document. But, even here, interesting de facto middle positions may be envisaged. Just imagine a scenario in which the new draft is adopted, unprecedently, by simultaneous plebiscites in all Member States. A public movement is in fact afoot calling for just such a process. Would this really confirm the constitutional status quo, or would it in effect be politically and constitutionally equivalent to a Europe-wide plebiscite?

After all, at the edges of constitutional discourse, the dividing line between law and politics becomes somewhat blurred. As a matter of legal realism, would not (or at least could not) the very political fact of simultaneous plebiscites give the new document the kind of constitutional authority which I have stipulated would only result from a Europe-wide popular consultation calling upon a single people of Europe as such? Note that I emphasised the legal realist perspective. Formally, such a procedure would seem to confirm the constitutional status quo. But, if in the mind of the constitutional communities which will have to deal with the results, it appears to be something different, that perception will become the new formal reality.

It is this move to classical constitutional polity — whether formally through a consultation with a single people or informally in the way I have just suggested — which seems so seductive. It is also entirely pragmatic and historical. One does not and cannot wait until the bonds of polity, of constitutional demos, or of loyalty are in place as a precondition for a constitutional settlement. The constitutional settlement is a voluntary invitation, self conscious and autonomous to create, over time, such a polity, such a demos and such a loyalty.

The best metaphor to capture this choice, with its idealism and stark realism combined, is marriage. At the moment of marriage, the young couple (setting passion aside) do not — and cannot — have the deep affection, loyalty and commonality which can only happen after years of living together and traversing the travails of life jointly. The nuptials are an invitation for a life-long process of marriage. Likewise, when peoples adopt a constitution, it is an invitation to a polity. The constitutional state, like the marriage state, is a process. Many Europeans ardently want to take that step.

Is there any virtue in the constitutional treaty, in the status quo, or is this option just a failure of nerve? Contrary to what one may initially think, the status quo and the constitutional treaty option reflect deep values.

Europe has, of course, a Constitution — in the same way that, say, the United Kingdom has one. Indeed, in the relationship between the Union and the Member States, Europe makes heavy constitutional demands, equal to and in some cases going beyond many a federal state.[4] But there remains one huge difference: Europe's constitutional principles, even if materially similar, are rooted in a framework which is altogether different. In federations, whether American or Australian, German or Canadian, the institutions of a federal state are situated in a constitutional framework which presupposes the existence of a 'constitutional demos', a single *pouvoir constituant* composed of the

[4] Some aspects of European market integration in goods exceed the United States; some aspects of labour mobility exceed Canada, to give but two examples.

citizens of the federation in whose sovereignty, as a constituent power, and by whose supreme authority the specific constitutional arrangement is rooted. Thus, although the federal constitution seeks to guarantee State rights, and although both constitutional doctrine and historical reality will instruct us that the federation may have been a creature of the constituent units and their respective peoples, the formal sovereignty and authority of the people coming together as a constituent power is greater than any other expression of sovereignty within the polity, and hence forms the supreme authority of the Constitution — including its federal principles.

Of course, one of the great fallacies in the art of 'federation-building', as in nation-building, is to confuse the juridical presupposition of a constitutional demos with political and social reality. In many instances, constitutional doctrine presupposes the existence of that which it creates: the demos which is called upon to accept the constitution is constituted, legally, by that very constitution, and often that act of acceptance is among the first steps towards a thicker social and political notion of constitutional demos. Thus, the empirical legitimacy of the constitution may lag behind its formal authority — and it may take generations and civil wars to be fully internalised — as the history of the US testifies. Likewise, the juridical presupposition of one demos may be contradicted by a persistent social reality of multiple *ethnoi* or *demoi* who do not share, or grow to share, the sense of mutual belongingness transcending political differences and factions and constituting a political community essential to a constitutional compact of the classical mould. The result will be an unstable compact, as the history of Canada and modern Spain will testify. But, as a matter of empirical observation, I am unaware of any true federal state, old or new, which does not presuppose the supreme authority and sovereignty of its federal demos.

In Europe, that presupposition does not exist. Simply put, Europe's constitutional architecture has never been validated by a process of constitutional adoption by a European constitutional demos and, hence, as a matter of both normative political principles and empirical social observation, the European constitutional discipline does not enjoy the same kind of authority as may be found in federal states whose federalism is rooted in a classic constitutional order. It is a constitution without some of the classic conditions of constitutionalism. True, there is a hierarchy of norms. True, Community norms trump conflicting Member State norms. But this hierarchy is not rooted in a hierarchy of normative authority or in a hierarchy of real power. Indeed, European federalism is constructed with a top-to-bottom hierarchy of norms, but with a bottom-to-top hierarchy of authority and real power.

It is this singularity of the extant European constitutional construct which encapsulates what is, in my eyes, its deepest and most original precept — its veritable *Grundnorm*: the principle of constitutional tolerance.

In political terms, a principle of tolerance finds a remarkable expression in the political organisation of the Community which defies the normal premise of constitutionalism. Normally in a democracy, we demand democratic discipline, that is, accepting the authority of the majority over the minority only within a polity which understands itself as being constituted of one people, however defined. A majority demanding obedience from a minority which does not regard itself as belonging to the same people is usually regarded as subjugation. This is even more so in relation to constitutional discipline. And yet, in the Community, we subject the European peoples to constitutional discipline even though the European polity is composed of distinct peoples. It is a remarkable instance of civic tolerance to accept being bound by precepts articulated not by 'my people,' but by a community composed of distinct political communities — a people, if you will, of others. I compromise my self-determination in this fashion as an expression of this kind of internal — towards myself — and external — towards others — tolerance.

Constitutionally, the principle of tolerance finds expression in the very arrangement which has now come under discussion: a federal constitutional discipline which, however, is not rooted in a statist-type constitution. Constitutional actors in the Member States accept the European constitutional discipline, but not because as a matter of legal doctrine, as is the case in the federal state, they are subordinate to a higher sovereignty and authority attaching to norms validated by the federal people, the constitutional demos. Rather, they accept it as an autonomous voluntary act of subordination, within the discrete areas governed by Europe, to a norm which is the aggregate expression of other wills, other political identities, other political communities, and this act is endlessly renewed on each occasion. Of course, to do so creates in itself a different type of political community, a unique feature of which is that very willingness to accept a binding discipline which is rooted in and derives from a community of others. The Quebecois are told: in the name of the people of Canada, you are obliged to obey. The French or the Italians or the Germans are told: in the name of the peoples of Europe, you are invited to obey. In both, constitutional obedience is demanded. When acceptance and subordination is voluntary, and repeatedly so, it constitutes an act of true liberty and emancipation from collective self-arrogance and constitutional fetishism: a high expression of constitutional tolerance.

The choice, now, seems stark. On the one hand, a move into new constitutional terrain evidenced by the two hallmarks mentioned above is highly attractive. On the other hand, the current architecture is of considerable value too.

Is it possible to adopt a formal constitution which would codify the principle of constitutional tolerance? I fear not. Tolerance is bred by the very fact that constitutional discipline is asked for, not demanded with the

authority of a formal constitution backed up by a constitutional demos. A choice, surely, will be made. Whether the profound significance of this choice will be appreciated or whether it will, instead, be taken for expedient, pragmatic reasons is less sure. From this perspective, it would seem that the current choice by the Convention is to be welcomed. It is a treaty masquerading as a Constitution. A treaty (preserving the voluntarist nature at the basis of constitutional tolerance) establishing a Constitution, and thereby preserving the constitutional discipline which is essential for the manifestation of that tolerance.

But, interestingly, the opposite might be true too, ie that we have here a Constitution masquerading as a treaty. There is much in the rhetoric of the Convention to suggest that this has been in the mind of the framers. The signs are already to be found in the Preamble (which puts in square brackets a reference to the treaty nature of the document and makes no explicit mention of treaty), in the aforementioned four-fifths adoption clause, in the introduction of a formal supremacy clause, etc. A process is possible whereby like a snake, the Constitution will shed its treaty skin. This will happen if, regardless of the formal criteria, the national legal orders, impressed by the solemnity, by the new formalism (formal supremacy, Charter and the like), by the method of adoption (Convention and plebiscites), and by the acts of adoption in the Member States, simply slide into a new constitutional settlement. Aiding this development would be the document's interpretation by a generation which grew with the current constitutional vocabulary and is unable to appreciate the originality and moral significance of the extant architecture. Indeed, if it turns out that one or two Member States fail to ratify, and the new Union finds a way to coerce them or exclude them, than what is now a contingent element in the current draft could become settled constitutional practice, overturning, de facto at least, the requirement of amendment by all Member States.

It may well be, then, that even if the current draft is adopted as a treaty which seemingly preserves the status quo, Europe will slouch into federal constitutional banality. These last 50 years will then be read by constitutional historians as an accidental 'Golden Age' and as proof of the long federal truism, that one cannot do what in fact Europe has managed constitutionally so successfully in the last half century.

CONSTITUTIONAL SPECIFICITY: EUROPE'S SOCIAL UNIQUENESS

The importance of constitutional choices does not lie only in the structure and process of government that they put in place. Constitutions are also about moral commitment and identity. We perceive our national constitutions as doing more than simply structuring the respective powers of government and

the relationships between public authority and individuals or between the state and other agents. Our constitutions are thought to encapsulate fundamental values of the polity and this, in turn, is said to be a reflection of our collective identity as a people, as a nation, as a state, as a Community, as a Union. When we are proud and attached to our constitutions, we are so for these very reasons. They are about restricting power, not enlarging it; they protect fundamental rights of the individual; and they define a collective identity which does not make us feel queasy in the way other forms of ethnic identity might. Mobilising in the name of sovereignty is passé; mobilising to protect identity by insisting on constitutional specificity is à la mode.

Europe prides itself on a tradition of social solidarity which found political and legal expression in the post-war welfare state, a model which all states of all political shades have embraced for years as an ideal and as a programmatic commitment. Universal health coverage, free education from kindergarten through university, generous welfare for the less fortunate, notably the unemployed, have been the proud hallmarks of this commitment. This was not just a question of political choice. Like the eventual rejection of the death penalty, this commitment became a source of identity, even pride — especially in comparison with the United States.

It would thus seem almost natural to give expression to that commitment in the European constitution. There is, of course, one obvious result. I predict with confidence that we will find in it the rhetoric of social solidarity, much as we did in Maastricht and, even more so, in Amsterdam. But the issue is whether this rhetoric should be translated into hard, constitutional guarantees. This poses a difficult choice. On the one hand, this is exactly the kind of commitment that could give the European constitution political traction and would make it a source of identity and identification.

But two considerations render this option problematic and, hence, the choice hard. The first concerns the ability to deliver. It is true that many would consider the commitment to social solidarity a fundamental European identity marker which should find its way into the European constitution. But for the most part, the essential features of the welfare state still rest within the jurisdiction and responsibility of the Member States, even if Europe as a whole contributes to the overall prosperity which enables the individual Member States to redistribute national resources within that welfare scheme. Arguably, Europe should not constitutionally promise and guarantee that which it cannot deliver, or is simply not its to deliver. To do so would risk either damaging the very credibility of the European constitutional construct or invite it into yet another massive encroachment on Member State competences — both unwelcome results.

The second consideration is more delicate. It would appear that the consensus around the classical Welfare State is no longer as solid as before. This is no longer a Thatcherite aberration, but part of political discourse in Spain, Italy, even Germany and other Member States. Is non-means-tested

free University education the sign of a progressive polity, or is it regressive redistribution from the less well off to the well off (who profit disproportionately from University education) masquerading as social solidarity? Would a health system which in part relied on means testing be both fairer and better? Are the entrenched provisions for labour security a trenchant commitment to social justice and a principled resistance to the pernicious effects of globalisation, or are they just a perk to a small segment of unionised labour, the perverse vestiges of latter day corporatism, damaging the prospects of prosperity for the wider polity? These questions, admittedly put here somewhat polemically, are increasingly part and parcel of political discourse in our Member States.

The hard constitutional choice becomes evident. A constitution is not only a repository of values. It also has considerable legal and political consequences. When something is placed in our constitutions, it is taken out of the normal political process. To constitutionalise Europe's historical commitment to the deep welfare state, with effective guarantees, is essentially to take those issues outside of politics, ie, above and beyond normal partisan parliamentary discourse and electoral politics. The notion of constitutional 'highjacking' comes to mind. It is not clear that these politics in today's Europe enjoy the kind of consensus which would justify such a move.

The constitutional choice here would appear to be particularly hard. If a meaningful commitment to welfarism is not enshrined in the constitution (and by meaningful, I mean something above the lowest common denominator), one of the great chances for crystallising European specificity into a defining document will have been lost. If such commitment is so enshrined, a deep irony will have been committed, namely taking a central issue, lying at the heart of public discourse, out of politics and hence out of the discipline of democracy, and doing so in the very document whose purposes include ensuring democratic legitimacy in the future decisional processes of Europe.

THE QUESTION OF COMPETENCES

The question of competences has been at the centre of the discussion. It seems to me, though, that the political process deliberating which competences are best assigned, reassigned or 'deassigned' to and from the Union, and how best to list these in the constitution, is focused on the wrong issues and is avoiding the truly hard choice.[5]

[5] A recent masterly presentation of the issues is I Pernice, 'Rethinking the Methods of Dividing and Controlling the Competences of the Union' *Europe 2004, Le Grand Debat* (The European Commission) <http://europa.eu.int/comm/dg10/university/post_nice/index_en.html> (22 October 2003).

Already during the debate accompanying the Maastricht Treaty, there erupted the dormant question of Community 'competences and powers.' This question and the accompanying debate found their code in, for example, the deliciously vague concept of 'subsidiarity.' This question has been inevitably connected to the continued preoccupation with governance structures and processes, with the balance between Community and Member States, and with the questions of democracy and legitimacy of the Community to which the Maastricht debate gave a new and welcome charge.

What Accounts for this Eruption?

First, a bit of history. The student of comparative federalism discovers a constant feature in practically all federal experiences: a tendency towards concentrations of legislative and executive powers in the centre, or general power, at the expense of constituent units. This concentration apparently occurs independently of the mechanism adopted for allocating powers or competences between centre and 'periphery.' Differences, where they occur, depend more on the ethos and political culture of polities than on legal and constitutional devices. The Community has both shared and differed from this general experience.

The Community has shared this experience in that it had, especially by the 1970s, seen a weakening of any workable and enforceable mechanism for the allocation of powers or competences between Community and its Member States.

This had occurred through a combination of two factors: (a) profligate legislative practices, mainly the use of what was then Article 235 ECT, and (b) the bifurcated jurisprudence of the European Court of Justice which, on the one hand extensively interpreted the scope of the Community's jurisdiction and, on the other hand, had taken a self-limiting approach towards the expansion of Community jurisdiction/competence/powers when exercised by the political organs. This is not meant as criticism of the Community, its political organs or the ECJ. The question is one of values. It is possible to argue that this process was beneficial overall to the evolution and well-being of the Community at the same time as it was beneficial to the Member States, its citizens and residents. But the process was also a ticking constitutional time bomb which one day could threaten the evolution and stability of the Community. Sooner or later, 'supreme' courts in the Member States would realise that the 'socio-legal contract' announced by the ECJ in its major constitutionalising decisions — namely, that the Community 'constitutes a new legal order … for the benefit of which the States have limited their sovereign rights, albeit within limited fields' — had been shattered. Although these 'supreme' courts had accepted the principles of the new

legal order — supremacy and direct effect — the fields in which these concepts played out seemed no longer limited. In the absence of Community legal checks, they would come to realise, it would fall upon them to draw the jurisdictional lines between the Community and its Member States.

Interestingly enough, the Community experience in this respect differs from the experience of other federal polities. Despite the massive legislative expansion of Community competences and powers, there had been little political challenge from the Member States. Why had this been so? The answer is simple and obvious, and it resides in the decision making process as it stood for decades within the Community of ten. Unlike the state governments in most federal states, the governments of the Member States, jointly and severally, could control the legislative expansion of Community jurisdiction. Nothing could be done without the assent of all states, and this defused almost any sense of threat or crisis on the part of governments. Indeed, if we want to look for 'offenders' who have disrespected the principle of limited competence, the main ones would be the governments of the Member States themselves, in the form of the Council of Ministers, conniving with the Commission and Parliament. How convenient to be able to do in Brussels what would often be politically more difficult back home, and then, exquisitely, to blame the Community! The ECJ's role in this regard has historically been not one of activism, but at most of active passivism. Even so, it did not build up a repository of credibility as a body which effectively patrols the jurisdictional boundaries between the Community and Member States.

This era passed with the shift to majority voting following the entry into force of the Single European Act (SEA), and the seeds — indeed, the buds — of crisis became visible. It became a matter of time before one of the national courts would defy the ECJ on this issue. Member States would become aware that, in a process which gives them neither de jure nor de facto veto power, the question of jurisdictional lines had become crucial. The Maastricht Decision of the German Federal Constitutional Court fulfilled this prediction, albeit later than anticipated.[6]

[6] There has been endless commentary; the following is a sample of diverse views: M Herdegen, 'Maastricht and the German Constitutional Court: Constitutional Restraints for an "Ever Closer Union" ' (1994) 31 *CML Rev* 235; HP Ipsen, 'Zehn Glossen zum Maastricht-Urteil' (1994) 1 *Europarecht*; J Schwarze, 'Europapolitik unter deutschem Verfassungsvorbehalt. Anmerkungen zum Maastricht-Urteil des BVerfG vom' (12 October 1993), NJW 1994, 1; E Steindorff, 'Das Maastricht-Urteil zwischen Grundgesetz und europäischer Integration' (1993) *Europaeisches Wirtschafts- und Steuerrecht* 341; C Tomuschat, 'Die Europäische Union unter Aufsicht des Bundesverfassungsgerichts' (1993) *Europaeische Grundrechtszeitschrift* 489; J Wieland, 'Germany in the European Union — The Maastricht Decision of the Bundesverfassungsgericht' (1994) 5 *European Journal of International Law* 259.

The decision could perhaps be read as an insistence on a more polycentered view of constitutional adjudication, designed to force a more even handed conversation between the European Court and its national constitutional counterparts. In some ways, the German move of the 1990s in relation to competences resembles their prior move in relation to human rights. It had only been that move which had forced the European Court to take human rights seriously.

But, in fact, the move by the German Federal Constitutional Court was not an invitation to conversation. Although the German Court mentioned that decisions on competences have to be taken in cooperation with the ECJ, it essentially reserved the last word to itself. A European diktat is simply replaced by a national one. And the national diktat is far more destructive to the Community, if one contemplates the possibility of 10, 12 or 15, not to mention 25 different interpretations.

How, Then, Can One Square this Circle?

The way out of this is not, I insist, by putting our faith in some list of competences which will be written into a European constitution. The attempt to arrest centralisation of power in this way has, in practically all federal states, failed. And, to those not schooled in federalism, a bitter lesson should be taught. Usually, the effect of any listing, positive or negative, of central competences in a federal constitution does not result in an arrest of central competences, but has the opposite impact. It gives constitutional value to interpretations which allow the central government to take such decisions. The failure is always more painful if it is part of a Constitution since it is now constitutional itself. The real issue is not the method of listing, but the policing of any method adopted.

The solution then lies in redesigning who will authoritatively interpret the reach of the functions and powers of the Community and Union.

One possible solution is institutional, and I would like to outline only its essential structure. I have repeatedly proposed the creation of a Constitutional Council for the Community, modelled in some ways after its French namesake.[7] The Constitutional Council would have jurisdiction only over issues of competences (but including subsidiarity) and would decide cases submitted to it after a law was adopted but prior to coming into force. It could be seized by any Community institution, by any Member State or national parliament, or by the European Parliament acting through a majority of its members. (It is important to empower the national parliaments in this regard since they are the typical losers in any expansion of

[7] JHH Weiler, 'The Reformation of European Constitutionalism' (1997) *Journal of Common Market Studies* 35(1).

European competences). Its president would be the President of the ECJ, and its members would be sitting members of the constitutional courts or their equivalents in the Member States. Within the Constitutional Council, no single Member State would have a veto power. The composition would also underscore that the question of competences is fundamentally also one of national constitutional norms, but still subject to a Union solution by a Union institution.

I will not elaborate here the technical aspects of the proposal. The proposal's principal merit is that it addresses the concern over fundamental jurisdictional boundaries without compromising the constitutional integrity of the Community, as did the Maastricht Decision of the German Federal Constitutional Court. Since, from a material point of view, the question of boundaries has a built-in indeterminacy, the critical issue is not what the boundaries are, but who gets to decide. On the one hand, the composition of the proposed Constitutional Council removes the issue from the purely political arena; on the other hand, it creates a body which would enjoy a substantial measure of public confidence, chiefly on account of its composition and its limited jurisdiction.

THE CHARTER

All modern constitutions contain a Bill of Rights. Under the current treaties, however, no such bill exists. It may seem strange that I include this issue in my list of hard choices. After all, the answer seems easy enough. There is a Charter; it was 'approved' in Nice. It would now be a simple matter not simply to approve it, but to adopt it constitutionally too. That should be done. The Charter is with us and we should make the best of it. But to do only that would, in fact, be the perfect way to avoid the hard choice in the matter of human rights. Let me explain.[8]

It is still worth asking about the Charter whether Europe really needed it, and whether it will actually enhance the protection of fundamental human rights in the Union. European citizens and residents do not, after all, suffer from a deficit in judicial protection of human rights. Their human rights in most Member States are protected by their constitution and by their constitutional court or other courts. By way of an additional safety net, they are protected by the European Convention on Human Rights and

[8] Here, too, the literature is already endless. For an illuminating symposium see, eg, J Dutheil de la Rochère, 'Droits de l'homme La Charte des droits fondamentaux et au delà' (Jean Monnet Working Paper 10/01); C McCrudden, 'The Future of the EU Charter of Fundamental Rights' (Jean Monnet Working Paper 10/01); G de Búrca, 'Human Rights: The Charter and Beyond' (2001) *The Future of the EU Charter of Fundamental Rights* (Jean Monnet Working Paper 10/01).

the Strasbourg organs. In the Community, they receive judicial protection from the ECJ, using as its source the same Convention and the constitutional traditions common to the Member States.

So Why a New Charter at All?

Most important in the eyes of the Charter promoters was the issue of perception and identity. Ever since Maastricht, the political legitimacy of the European construct had been a live issue, and the advent of European Economic and Monetary Union (EMU) with its barely accountable European Central Bank added fuel to a perception of a Europe concerned more with markets than with people. It may be true that the European Court guarantees legal protection against human rights abuses, but who is aware of this?

A Charter, its supporters said, would render visible and prominent that which until now was known only to dusty lawyers. Additionally, the Charter, as an important symbol, would counterbalance the Euro, become part of the iconography of European integration, and contribute both to the identity of, and identification with, Europe.

Time will tell whether this has been borne out, but for now the Charter is a classical European story, akin to the concept of European citizenship heralded with great triumph at Maastricht. It is an exercise characterised by highfalutin' rhetoric by all and sundry and a simultaneous conspicuous failure to take decisive steps toward integration into the legal order of the Union. We have become so habituated to this kind of Euro 'double-speak' that we fail even to notice.

Lawyers point out with great excitement that Advocates General of the Court (and now the Tribunal of First Instance) are already making reference to the Charter and that it may become 'incorporated' in the legal order by judicial activity. I am not at all sure whether this is a positive development, both from pragmatic and normative perspectives. I wonder if a stony silence by the Court, or a defiant refusal to take note of the Charter would not, pragmatically, provide greater impetus to eventual political action. I also wonder, as indicated above, whether it is proper for the Court to go very far with judicial incorporation of the Charter given the fact that it was, let us not mince words, constitutionally rejected as an integral part of the Union legal order. One cannot chant odes to democracy and constitutionalism, and then flout them when it does not suit one's human rights agenda. It seems as if the Court itself has heeded these warnings.

Clarity was a second common justification for the Charter. The current system of looking to the common constitutional traditions and to the European Convention as a source of rights protected in the Union, it has been argued, is unsatisfactory and needs to be replaced by a formal document

listing such rights. But would clarity actually be added? Examine the text. It is, appropriately, drafted in the magisterial language characteristic of our constitutional traditions: human dignity is inviolable etc. There is much to be said for this tradition, but clarity is not one of them. When it comes to the contours of the rights protected, I do not believe that the Charter adds much by way of clarity to what exactly is protected and what is not.

However, by drafting a list and perhaps one day fully incorporating it into the legal order, we will have jettisoned, at least in part, one of the truly original features of the pre-Charter constitutional architecture in the field of human rights, the ability to use the legal system of each of the Member States as an organic and living laboratory of human rights protection which then, case by case, can be adapted and adopted for the needs of the Union by the European Court in dialogue with its national counterparts. The Charter may not thwart that process, but it runs the risk of inducing a more inward looking jurisprudence and chilling the constitutional dialogue.

Drafting a new Charter, it was claimed, would give an opportunity to introduce much needed innovation into our constitutional norms which, after all, were shaped by ageing constitutions and international treaties. Issues such as biotechnology, genetic engineering, privacy in the age of the internet, sexual identity and, most importantly, political rights empowering the individual, all could be dealt with afresh by placing the Charter at the avant-garde of European constitutionalism. I leave it to the reader to judge whether the Charter has introduced such innovation. In some instances, the language used by the Charter risks 'deconstitutionalisation' of certain rights. The formula quite frequently used — rights '…guaranteed in accordance with the national laws governing the exercise of these rights' — may turn out to do considerable damage to constitutional protection of human rights. Whilst it is a formula one commonly finds in the constitutional orders of the Member States and international treaties, and whilst it is possible to develop a jurisprudence which separates the existence of a right from its exercise, in the particular circumstances of the Community, it will be very difficult ever to challenge constitutionally a Community (let alone a Member State) measure which replicates the existing law in this or that Member State. This may turn out to be a very regressive development for the protection of human rights.

Another regressive scenario is one under which the Court will feel great pressure to reject any progressive interpretation of the various formulae found in the Charter, if this turns out to be one that was rejected by the Convention which drafted the Charter. For example, a proposal to introduce into the Charter 'the right for everyone to have a nationality' was rejected during the drafting process. It will be difficult for the Court to articulate such a right. Likewise, genetic integrity was dropped from Article 3 on the Integrity of the Person. This too might have subsequent interpretative consequences, and many more examples can be found. In some

respects, the Charter actually cuts down on protection now offered in the legal order of the Community. Article 51(1) thus actually reduces the categories of Member State acts which would be subject to European scrutiny, and Article 53 at least raises problems as to the supremacy of Community law in this area.

But most troubling of all is the fact that the Charter exercise served as a subterfuge — an alibi — for not doing that which was truly necessary if the purpose was truly to enhance the protection of fundamental rights in the Union rather than talk about enhancing such protection.

The real problem accordingly is the absence of a human rights policy with everything this entails: A Commissioner, a Directorate General, a budget and a horizontal action plan for making effective those rights already granted by the Treaties and judicially protected by the various levels of European courts. Much of the human rights story, and its abuse, takes place far from the august halls of courts. Most of those whose rights are violated have neither knowledge nor means to seek judicial vindication. The Union does not need more rights on its lists, or more lists of rights. What are mostly needed are programs and agencies to make rights real, not negative interdictions which courts can enforce.

The best way to drive the point home is to think of competition policy. Imagine our Community with an Article 81 and 82 interdicting restrictive practices and abuse of dominant position, but not having a Commissioner and a Directorate-General (DG) for Competition to monitor, investigate, regulate and prosecute violations. The interdiction against competition violations would be seriously compromised. But that is exactly the situation with human rights. For the most part, the appropriate norms are in place. If violations were to reach the Court, the judicial reaction would be equally appropriate. But would there be any chance of effectively combating antitrust violations without a DG Competition? Do we have any chance in the human rights field, without a similar institutional set up?

One reason we do not have a policy is because the Court, in its wisdom, but erroneously in my view, announced in Opinion 2/94 that protection of human rights is not one of the policy objectives of the Community and thus cannot be a subject for a proactive policy. Thus, far more important than any Charter for the effective vindication of human rights would have been a simple Treaty amendment making active protection of human rights within the sphere of application of Community law one of the proper policies of the Community, alongside other policies and objectives in Article 3, coupled with commitment to take expeditiously all measures to give teeth to such a policy.[9] Not only was such a step not taken, but Article 51(2) of

[9] For a full fledge discussion of the need and content of such a policy, see P Alston and JHH Weiler, 'An 'Ever Closer Union' (1999) *Need of a Human Rights Policy: The European Union and Human Rights*. (Jean Monnet Working Paper 1/99) <http://www.jeanmonnetprogram.org/papers/99/990101.html> (2 March 2004).

the charter renders such a development even more difficult to take in the future.

The single most important thing the next IGC can do for human rights is not the adoption of the Charter (though at this point continued rejection of the Charter would be in and of itself very damaging) but rather the commitment to, and adoption of, a human rights policy within, of course, the sphere of application of Community law and not beyond. This is not conceptually a hard choice at all. Politically, it might be the hardest of all.

ENTRY INTO FORCE AND FUTURE AMENDMENT

I noted earlier in this essay that one of the hallmarks of a constitution was to be found in the amendment procedure. To be amended, treaties require the consent of each single High Contracting Party. Constitutions generally employ some form of qualified majoritarianism, as a sign of polity. When we find a multipartite Treaty which employs in its amendment procedure the majority principle, that is a sign of movement into constitutional terrain.

The combination of Constitution and treaty in the very nomenclature of the current European exercise is a hint of a certain deep-seated dilemma. We see, on the one hand, a reluctance to embrace fully the notion of a constitution and, on the other hand, a certain impatience with some of the disciplines of the Treaty, notably that represented by the amendment process. Imagine in a Union of 25 a repetition of the Irish Nice saga: the entire Union holding its breath to see if a majority of the electorate of one state (Malta? Cyprus? Estonia? Luxembourg?) will allow the new Treaty to come into force, indeed allow any amendment to come into force. The principle of state sovereignty, as understood in public international law, dictates the need of such approval by each of the High Contracting Parties. The principle of democracy, as understood in most forms of constitutional federalism, militates against such extreme empowerment of constituent units.

It would be appropriate, in a constitutional treaty, or treaty establishing a Constitution, to find some intermediate position. Two such innovations are under discussion. In my view, they ought to be understood as part of the package. One is the Withdrawal Clause (already found in the Draft Constitution) leaving open the possibility of a Member State to withdraw. The other is the differentiated amendment procedure, which is under discussion but does not seem to have made it into the final draft.

The differentiated amendment process envisages a set of core articles in the Constitutional Treaty which could not be amended without the assent of all High Contracting Parties. All other articles could be amended by some form of super majority. As I have indicated earlier, removing the ability of a

single Member State to block an amendment is a sign of polity transcending the political boundaries of the Member State. It is against this background that the Withdrawal Clause should be understood, for the clause conceptually reaffirms and politically reinforces the principle of state sovereignty. Whilst it disables an individual Member State from blocking the 'progress' of the entire Union, it also, unlike a Constitutional order, disables the Union from forcing its constitutional will on that of a recalcitrant Member State, by allowing the latter legally and unilaterally to withdraw from the compact. It is a device both principled and expedient.

CONCLUSIONS: THE CONSTITUTIONAL MOMENT

It is a characteristic of the development of the European construct that inordinate attention has always been given to the political process of decision making. Constitutional developments, often of profound consequence since they condition the very 'operating system' of the polity, have, by comparison, occurred almost by stealth.

But now we have had a Convention truly deliberating the Future of Europe: a Constitutional Convention. I have highlighted five fundamental constitutional issues: the constitutional significance of enlargement; the issue of form (Constitutional Treaty or Constitution), social solidarity and the material specificity of a European constitution; the necessity of policing competences rather than allocating them; and the value of a constitutional amendment which would allow a human rights policy. The first and most consequential of these, enlargement, has de facto already been taken with a deliberative process bearing an inverse proportion to the gravity of the issue. The others are most likely either to be decided or to be 'non-decided' by default and/or pragmatism. This should not, however, occasion expressions of woe. It is a matter of legal hubris to imagine that constitutions really constitute. All these issues are but bends and dykes in the river which can channel somewhat, retard somewhat, but never truly affect the course of human affairs. The future of Europe, in the true, profound sense, will not be decided by either the Convention or the IGC. At moments like this, the notion of a Convention that is 'out there' and that we observe, whether analytically or normatively, is fallacious. Citizens and intellectuals are also part of the Convention and have a role in 'constituting' Europe. By this I do not refer to the charade of consulting so-called 'civil society.' (In any event, academics are notorious for being uncivil). They become part of the Convention by helping to define, through and by their thoughts, passions and responses, the very political culture which shapes who we are, what our values are, and how, in light of that, our polity and its multifaceted society will be constituted.

References

Alston, P, and Weiler, JHH (1999) 'An "Ever Closer Union" in Need of a Human Rights Policy: The European Union and Human Rights' (Jean Monnet Working Paper 1/99).

Chirac, J (2000) *Our Europe* (London, Federal Trust).

de Búrca, G (2001) 'Human Rights: The Charter and Beyond' *The Future of the EU Charter of Fundamental Rights* (Jean Monnet Working Paper 10/01).

Dutheil de la Rochère, J (2001) 'Droits de l'homme La Charte des droits fondamentaux et au delà' (Jean Monnet Working Paper 10/01).

Giscard d'Estaing, V and Schmidt, H (2000) 'Time to slow down and consolidate around "Euro-Europe"' *International Herald Tribune* (11 April 2000).

Habermas, J (1992) 'Citoyenneté et identité nationale. Réflexions sur l'avenur de l'Europe' in J Lenoble and N Dewandre (eds), *L'Europe au Soir du Siècle: Identité et Démocratie* (Paris, Esprit).

—— (1999) 'The European Nation-State and the Pressures of Globalization' 235 *New Left Review* 46.

—— (2001) 'So, Why Does Europe Need a Constitution?' *European University Institute* (Fiesole, Robert Schuman Centre).

Herdegen, M (1994) 'Maastricht and the German Constitutional Court: Constitutional Restraints for an "Ever Closer Union"' 31 *Common Market Law Review* 235.

Ipsen, HP (1994) 'Zehn Glossen zum Maastricht-Urteil' 1 *Europarecht*.

Joerges, C, Meny, Y, and Weiler, JHH (2000) *What Kind of Constitution for What Kind of Polity? Responses to Joschka Fischer* (Florence/Harvard Law School, Cambridge, MA, Robert Schumann Centre EUI).

Leonard, M (2000) (ed), 'The Future Shape of Europe' *The Foreign Policy Centre*.

McCrudden, C (2001) 'The Future of the EU Charter of Fundamental Rights' (Jean Monnet Working Paper 10/01).

Pernice, I (2004) 'Rethinking the Methods of Dividing and Controlling the Competences of the Union' *Europe 2004, Le Grand Debat* (The European Commission).

Schwarze, J (1994) 'Europapolitik unter deutschem Verfassungsvorbehalt. Anmerkungen zum Maastricht-Urteil des BVerfG vom' (12 October 1993), NJW 1994, 1.

Steindorff, E (1993) 'Das Maastricht-Urteil zwischen Grundgesetz und europäischer Integration' *Europaeisches Wirtschafts- und Steuerrecht* 1993.

Tomuschat, C (1993) 'Die Europäische Union unter Aufsicht des Bundesverfassungsgerichts' *Europaeische Grundrechtszeitschrift* 489.

Weiler, JHH (1997) 'The Reformation of European Constitutionalism' 35 *Journal of Common Market Studies* 97.
Wieland, J (1994) 'Germany in the European Union — The Maastricht Decision of the Bundesverfassungsgericht' 5 *European Journal of International Law* 259.

3

The Role of the EU Charter of Rights in the Process of Enlargement

WOJCIECH SADURSKI

THE EUROPEAN UNION is currently undergoing two major, historical transformations which will profoundly alter its nature, structure and meaning: the constitutionalisation process and the eastward enlargement.[1] Each of these processes, taken in isolation, constitutes a fundamental transition of strategic, even historic proportions: taken together, they offer both a major challenge (perhaps even a threat) to, and a major opportunity for, the future of Europe.

The threat can be seen in the deep potential for negative interactions between these two processes. In the traditional perspective, the 'deepening' (often, even if misleadingly, associated with constitutionalisation)[2] is seen as antithetical to the 'widening'. As some authors have noted, these processes (constitutionalisation and enlargement) have ultimately different, and even mutually incompatible, in-built dynamics. Constitution-making is a purposive, open-ended, and dynamic process which invites and indeed requires constant contestation, argument, challenges and interchangeability in the roles of norm-setter and norm-follower.[3] Enlargement, by contrast, is rooted in 'conditionality', and may be seen as a process in which the rules of accession are virtually set in stone, frozen in a particular historical moment, with the rule-followers subordinate to the rule-setters, and the

[1] Only the imminent entry into the EU of the former communist states of Central and Eastern Europe (CEE) is of concern for this chapter but this, of course, is not to neglect the significance of accession to the EU by Malta and Cyprus. The argument in this paper is CEE specific.
[2] The demands for constitutionalisation do not necessarily accompany those for 'more Europe'; one may see the constitution of EU as a means of halting further integration; see, for example, 'A constitution for the European Union' *The Economist* (London, UK, 26 October 2000) <http://www.economist.com/printedition/displayStory.cfm?Story_id=S%26%28X%2C%2FRA%3F%22%0A> (9 December 2003).
[3] See A Wiener, 'Finality vs. Enlargement: Constitutive Practices and Opposing Rationales in the Reconstruction of Europe' (Jean Monnet Working Paper 8/02) 6–7: <http://www.jeanmonnetprogram.org/papers/02/020801.pdf> (1 December 2003).

'take it or leave it' principle permeating the whole process. In addition, there is an understandable concern that the effect of enlargement upon internal EU democracy, for what it is worth, may be detrimental. Put differently, 'enlargement may worsen the alleged democratic deficit, by diluting even more the voice of the single citizen in the European decision-making process; it may also make the prospect of the emergence of a true European *demos* more remote than before.'[4]

I will focus here, however, on the opportunities rather than risks stemming from the current coincidence of enlargement and constitutionalisation and, more particularly, on the synergies rather than the antinomies. A good starting point is the realisation that this is not a 'coincidence' at all, but rather that the prospect of enlargement has been one of the powerful reasons for constitutionalisation (or, as Bruno de Witte puts it, enlargement was a constitutional agenda setter for the European Union).[5] I confine my consideration of constitutionalisation in the EU to only one of its aspects, namely, the inclusion of fundamental rights within the constitutional structure of the Union, as dramatically symbolised by the adoption of the Charter of Fundamental Rights. This is, of course, not the only and perhaps not even the major aspect of Union constitutionalisation. If the attention given to the Charter during the Convention on the Future of the Union, compared to other major issues discussed there, is any indication of the weight it received, and if the Convention is seen as an expression of the interests and concerns of the European national and supranational elites about the future of the Union, then the focus on the Charter in this chapter may seem misplaced. But this is not so. The Convention has attached very little attention to the Charter basically because the Charter has been a relatively non-contentious issue, at least compared to the issues of the institutional architecture of the Union, the division of competences between the Union and the Member States, and so on. Moreover, the Charter was presented to the Convention as a package which should not be opened, with its substance non-negotiable, and the only open matter being its status in the future constitutional treaty.[6] Since there is a near-consensus that the

[4] B de Witte, 'The Impact of Enlargement on the Constitution of the European Union' in Marise Cremona (ed), *The Enlargement of the European Union* (Oxford, Oxford University Press, 2003) 209–52 at 228.
[5] De Witte, *ibid*.
[6] Working Group II of the Convention, in its Final Report of 22 October 2002, explicitly stated that the Charter as endorsed by the Nice European Council 'should be respected by this Convention and not be re-opened by it,' 'Final report of Working Group II' *The European Convention* (Brussels, 22 October 2002) CONV 354/02 <http://register.consilium.eu.int/pdf/en/02/cv00/00354en2.pdf> (1 December 2003) at 4. This had been already announced at the outset, as part of the 'mandate of the Working Group on the Charter,' by the Working Group's Chairman, Antonio Vitorino, in his Note of 31 May 2002, see 'Mandate of the Working Group on the Charter' *The European Convention* (Brussels, 31 May 2002) CONV 72/02

Charter's elevation to the status of a legally binding document is inevitable,[7] the only issues which were really discussed at the Working Group II dealing with the Charter concerned relatively marginal matters (which may excite some lawyers but which look to the general public like hair-splitting) namely the issue of the precise method of incorporation: either insertion of the full text of the Charter into the Constitutional Treaty or inclusion of a reference to the Charter in one of the articles of the Treaty?[8]

In fact, the significance of the Charter — and, more generally, of the place of human rights in the EU in the years to come — is anything but trivial, and has been already described as no less than 'herald[ing] a reorientation of the historic mission of the Community.'[9] This significance, as I argue, becomes particularly clear when one considers the relationship between the Charter (again, as a reflection of the place of human rights in the EU) and enlargement, the latter viewed in terms both of the accession process itself and of the post-accession situation. As far as the accession process is concerned, the Charter performed a useful role in reducing, if not fully overcoming, some disturbing aspects of what may be called human rights conditionality. Indeed, I will argue that it could have played an even more significant role if during the Convention, which happened to open in the eleventh hour of the accession negotiations, the *diktat* about the non-negotiable character of the Charter had not been imposed with such force. This will be the theme of the first part of this chapter.

In the second part, I shift the focus somewhat and begin by looking at an issue which may appear unrelated to the Charter's role in enlargement, namely the 'sovereignty conundrum', by which I mean the unease that may be strongly felt within the Central and East European States about 'losing sovereignty' upon joining the EU. While such unease could have adversely affected the strength of support for accession in those states, and consequently, their bona fide commitment to the deepening and constitutionalisation of political

<http://register.consilium.eu.int/pdf/en/02/cv00/00072en2.pdf> (1 December 2003), and indeed, such was the mandate as formulated in Nice and in Laeken. The Declaration on the Future of the Union adopted in Nice in December 2000 proclaimed, among other things, that one of the aims of the Inter-Governmental Conference in 2004 will be to discuss 'the *status* of the Charter of Fundamental Rights of the European Union proclaimed in Nice….' Declaration on the Future of the Union to be Included in the Final Act of the Conference, Annex IV, (Nice, SN 533/00, 12 December 2000) (emphasis added).

[7] The Final Report of Working Group II states that all members of the Group either support an incorporation of the Charter in a form which would make it legally binding or 'would not rule out giving favourable consideration to such incorporation,' CONV 354/02, above n 6, at 2.

[8] In addition, the Working Group dealt with the question of possible accession of the Community / the Union to the ECHR.

[9] G de Búrca, 'Human Rights: The Charter and Beyond' (Jean Monnet Working Paper No 10/01) <http://www.jeanmonnetprogram.org/papers/01/013601.html> (10 December 2003) at 7.

integration within the EU, this effect could be greatly minimised by the perception of the EU as a human rights relevant polity. In this way, the Charter — as the epitome of the EU's commitment to strong human rights protection in Member States — may be seen as instrumental in both the enlargement and the socialisation of the accession states into a politically integrated, constitutionalised Union.

Finally, in the conclusion, I attempt to tie these two threads together by reflecting upon the synergy between the enlargement and the Charter aspects of constitutionalisation. In that way, I will return to the point with which I opened, namely that the concurrence of enlargement and constitutionalisation offers not only a threat but also a series of opportunities for the Union as a whole.

THE CHARTER AND HUMAN RIGHTS CONDITIONALITY

As I have tried to show elsewhere,[10] there is a certain parallelism between the enlargement dynamic and the dynamic of the EU's taking onboard of the issue of individual rights. This parallelism responds to a frequently noted contrast between the scope of human rights which have so far largely been the subject of internal EU concerns and human rights conditionality applied by the EU to candidate states. As Andrew Williams has remarked, the EU has adopted, in its enlargement strategy, a policy 'whereby individual applicant states are subjected to a process of human rights scrutiny and intervention … which possesses no imitation within the European Union', and as a result 'the scope of rights so scrutinised in the accession criteria extends some way beyond that which falls within the European Union's internal concerns.'[11]

At an early stage of the rapprochement between the EC and the candidate states, soon after the 1989 transitions, there was a good deal of rhetoric on both sides about human rights being an important means of embracing those states in whatever form in the larger, pan-European entity that had been forming after the Second World War on the western side of the Iron Curtain.[12] But it was just that: political rhetoric. The main rationale for the

[10] W Sadurski, 'Charter and Enlargement' (2002) 8 *European Law Journal* 340.

[11] A Williams, 'Enlargement of the Union and Human Rights Conditionality: a Policy of Distinction?' (2000) 25 *EL R* 601 at 601–2. See also more generally (not just in the context of enlargement) P Alston and JHH Weiler, 'An "Ever Closer Union" in Need of a Human Rights Policy: The European Union and Human Rights' in P Alston (ed), *The EU and Human Rights* (Oxford, Oxford University Press, 1999) 9; B de Witte and G Toggenburg, 'Human Rights and Membership of the Union' in S Peers and A Ward (eds), *The EU Charter of Fundamental Rights* (Oxford, Hart, 2003) 59–82.

[12] For instance, as early as 1990, the European Council declared (at its meeting in Dublin on 28 April) that '[the] process of change brings ever closer a Europe which, having overcome the

early cooperation agreements (the 'Europe Agreements') had much more to do with the promotion of free market ideals, and the twin goals of stability on the continent and international security, than of human rights and constitutionalism.[13] This changed with the Copenhagen criteria of 1993,[14] which were then followed by human rights scrutiny within the framework of the so-called 'accession partnerships' of 1998 — a system whereby the achievement of specific 'objectives' for particular candidate countries, itemised within Partnership documents, was assessed through regular annual country reports.[15]

These matters — democracy, the rule of law and human rights — have largely been taken for granted within the Community itself, and never before 1993 were they included in a formal set of criteria for applicant countries, whose democratic and human rights credentials always seemed impeccable to the members at the time. And this was the case not only because earlier candidate states were above suspicion; in fact, a fundamental ambiguity had persisted as to whether human rights matters were relevant to the Community at all.[16] This ambiguity stemmed from the fact that, on the one hand, the absence of specific Treaty bases granting legal powers to the Community in the field of human rights meant that the competence of the Community in this field was questionable. On the other hand, the long line of ECJ jurisprudence declaring respect for fundamental human rights to be part of the Community legal system, culminating in general pronouncements in Article 6 of the TEU about the Union being 'founded on' respect for human rights, and the Article 7 mechanism for EU intervention in its Member States in the field of human rights, suggest 'a significant degree of competence in the field of human rights.'[17] As a consequence, EU

unnatural divisions imposed on it by ideology and confrontation, stands united in its commitment to democracy, pluralism, the rule of law, full respect of human rights, and the principles of market economy', quoted in Williams, above n 11, 604.

[13] See T King, 'The European Community and Human Rights in Eastern Europe' (1996) 23 *Legal Issues of European Integration* 93, in particular at 103.

[14] The Council, held in Copenhagen in 1993, established that in order to be successful in its pursuit of full membership the applicant state must enjoy, inter alia, 'stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities … .'

[15] See Williams, above n 11, 609–10.

[16] For a succinct statement of this ambiguity, see G de Búrca, 'Convergence and Divergence in European Public Law: The Case of Human Rights' in P Beaumont, C Lyons and N Walker (eds), *Convergence and Divergence in European Public Law* (Oxford, Hart Publishing, 2002) 131 at 135–40. For another brief description of 'a long record of ambivalence [of the EU and its predecessors] towards fundamental rights,' see N Walker, 'Human Rights in a Postnational Order: Reconciling Political and Constitutional Pluralism' in T Campbell, KD Ewing and A Tomkins (eds), *Sceptical Essays on Human Rights* (Oxford, Oxford University Press, 2001) 119 at 120–21 (the quoted words are from page 120).

[17] De Burca, above n 16 at 138.

legal scholars can keep disagreeing in good faith about whether the EU is 'rights-based,' and how central the rights are to the Union itself.[18]

In the context of the enlargement process, post-1993, the contrast between the rules for existing members and the admission criteria for prospective newcomers became sharp, even if its causes were understandable. To be sure, inclusion of a reference to the principles of liberty, democracy, and respect for human rights in the Treaty of Amsterdam[19] might be seen as having somewhat reduced the contrast. On the basis of this inclusion, it has been claimed that human rights were proclaimed in the Amsterdam Treaty as explicit preconditions for EU membership.[20] However, it has also been noted that the Copenhagen criteria are not coextensive with the principles proclaimed in Article 6(1) of TEU. In particular, a specific reference to the protection of minorities is one of the Copenhagen criteria, but is missing from the Treaty's human rights provision.[21] So, even if Article 6(1) of the Treaty (TEU), in connection with the newly established procedure for the suspension of rights of Member States in the case of breach of these principles (Article 7 TEU), may alleviate the contrast between the external and internal EU human rights requirements, the indisputable fact is that none of the current Member States faced these preconditions at the point of their admission, and that no earlier enlargement had been conditioned by rules regarding democracy and human rights. (On the other hand, one must not exaggerate the practical — as opposed to the symbolic — political role played by the Copenhagen criteria in the actual control of the candidate states' compliance with the conditions of membership; as far as the Central and Eastern European states are concerned, with one exception which is now of historical interest only, no negative grade was ever given to any of the applicant states on that basis in the Commission's annual opinions on progress towards accession.)[22]

[18] Compare, eg, AJ Menéndez, 'A Rights-Based Europe?' in EO Eriksen, JE Fossum and AJ Menéndez (eds), *Constitution-Making and Democratic Legitimacy* (Oslo, Arena, 2002) 123–51 (claiming that European integration has been, from its very beginning, founded on fundamental rights) with A von Bogdandy, 'The European Union as a Human Rights Organization? Human Rights and the Core of the European Union' (2000) 37 *CML Rev* 1307 (expressing scepticism about viewing human rights as the core of the EU).

[19] Art 6(1) TEU: 'The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to Member States.'

[20] See M Novak, 'Human Rights "Conditionality" in Relation to Entry to, and Full Participation in, the EU' in Alston, above n 11, 689–90.

[21] See Novak, *ibid* 692.

[22] The exception was Slovakia in 1997; the Luxembourg summit of December 1997 decided to exclude Slovakia from accession negotiations on the basis that the then Meciar government failed to meet the political conditions; the Commission's avis of July 1997 referred to 'the instability of Slovakia's institutions, their lack of rootedness in political life and the shortcomings in the functioning of its democracy,' see G Pridham, 'The European Union's Democratic Conditionality and Domestic Politics in Slovakia: the Meciar and Dzurinda Governments

The causes of this contrast are, as I have said, understandable. There has been a natural suspicion in the Western part of Europe over the depth and sincerity of democratic transformations in the Central and Eastern parts of the continent. For reasons of geographic and cultural proximity, this suspicion was not felt within the then Member States when Spain, Portugal and Greece joined the European Community after their own abandonment of authoritarian rule. While the absence of democracy in these three Southern societies was seen as an aberration, in Central Europe it is seen as a chronic state of affairs. As George Schöpflin notes:

> The burdens of the short- and long-term past, the negative practices of post-Communism itself, the dangers of spillover from the interface between democracy and authoritarian systems … all implied that greater vigilance [on the part of the EU] was needed. To that extent, democracy and liberalism could be taken for granted in Western Europe, whereas in Central and South-Eastern Europe it could not.[23]

Schöpflin is right, and his remarks imply that to characterise the practice discussed here as a case of 'double standards' is not necessarily to condemn it. The EU's use of double standards in its human rights vigilance was largely justified, not least because it was welcomed by democratic activists in the candidate states themselves, who saw EU human rights conditionality as an additional tool for consolidating democracy and the protection of rights in their own countries. This is an important point. From the internal perspective of the candidate states, such a situation of 'double-standards' was not necessarily viewed with hostility; indeed, it has sometimes been applauded, as a device for prodding the candidate states into adopting more democratic and consensual institutional designs.[24]

But this contrast between 'external' and 'internal' standards became, in the long run, untenable. Moreover, from the perspective of the candidate states, the contrast led to uncertainty about which specific standards and criteria — going beyond the vague formulations of the Copenhagen criteria — would be used as a yardstick to assess their alignment with EU-wide human

Compared' (2002) 54 *Europe-Asia Studies* 203 at 224 fn 3. At the Helsinki summit of December 1999, the new government of Dzurinda (elected in 1998) won agreement to open negotiations as from February 2000.

[23] G Schöpflin, 'Liberal Pluralism and Post-Communism' in W Kymlicka and M Opalski (eds), *Can Liberal Pluralism be Exported? Western Political Theory and Ethnic Relations in Eastern Europe* (Oxford, Oxford University Press, 2001) 109–25 at 124. For a strong expression of similar sentiments, see M Cartabia, 'Allargamento e diritti fondamentali nell'Unione Europea. Dimensione politica e dimensione individuale' in S Guerrieri, A Manzella and F Sdogati (eds), *Dall'Europa a Quindici alla Grande Europa. La Sfida Istituzionale* (Bologna, Il Mulino, 2001) 123–49.

[24] See, eg A Agh, 'Ten Years of Political and Social Reforms in Central Europe' (2002) 2 *Central European Political Science Review* 24 at 39–40.

rights standards.[25] The EU Charter of Fundamental Rights may be viewed as a remedy for this problem, ie, as a step taken in order to close the gap between external requirements and internal human rights policy, and also to add a degree of clarity — or specificity — to the actual content of the human rights conditions.[26] From the perspective of the candidate states, the closing of the gap between external and internal human rights standards helped dispel the suspicion, which was never quite absent, that human rights conditionality had been tailored as a somewhat cynical instrument for allowing access to be denied to selected candidate states even after they had fulfilled all the other, more tangible and verifiable, requirements of the *acquis*. There always was a suspicion — not quite irrational, as some observers suggested[27] — that human rights conditionality rendered the EU a 'moving target' for the candidate states, and that it allowed the Union to keep changing the rules of the game due to its position as an arbiter of what constituted meeting the vague Copenhagen tests.

To be sure, the 'moving target' factor cannot be dismissed as merely a cynical ploy, that is, as a device to prevent bona fide candidates from joining the club should the political will on the part of the current members to proceed with enlargement evaporate. The EU constitutional logic, of which the human rights element is an ingredient, is in inevitable tension with the logic of conditionality. The former is dynamic and evolving in a direction which does not have clear, obvious and consensually agreed upon parameters (hence, the ongoing debates about 'finality'). The latter is based on the idea of a static, identifiable and unchanging set of conditions. As Antje Wiener argues

> [w]hile the participants of the constitutional debate find it hard to agree on a compromise towards thinning out a thicket of institutionalised rules and norms, the candidate countries are often forced to comply with norms which remain dubious and under-specified in the EU's very own context.[28]

[25] Koen Lenaerts recently deplored the 'overall lack of transparency in the external human rights policy of the European union' as a result of which 'the countries applying to join the Union … are not aware of the basis on which their performances will be evaluated by the E … .': K Lenaerts, 'The Impact of the EU Charter of Fundamental Rights in the Perspective of Enlargement' in AE Kellerman, JW de Zwaan and J Czuczai (eds), *EU Enlargement: The Constitutional Impacts at EU and National Level* (The Hague, TMC Asser Press, 2001) 447–79 at 474.

[26] Commission communication on the Charter of fundamental rights of the European Union COM (2000) 0559 final, para 12: '[T]he adoption of a catalogue of rights will make it possible to give a clear response to those who accuse the Union of employing one set of standards at external level and another internally.'

[27] See eg H Grabbe, 'European Union Conditionality and the *Acquis Communautaire*' (2002) 23 *International Political Science Review* 249 at 251.

[28] Wiener, above n 3 at 4. See also A Wiener and G Schwellnus, 'Contested Norms in the Process of EU Enlargement: Non-Discrimination and Minority Rights', ch 20 of this volume.

With regard to the Charter, the concerns frequently expressed by the representatives of the candidate states during their so-called 'auditions' in the course of preparing the draft Charter — that the Charter should not add to the conditions and burdens of the *acquis* [29] — reflect precisely that reality of the 'moving target'. Candidates to join the club want to know that the conditions of membership will not keep changing in the period between initial application and the final vetting of the applicant's profile. On the other hand, however, the fact that the conditions of membership were changing was not, or was not only, an expression of a manipulative politics on the part of the Member States but also a reflection of the very character of the constitutionalisation of the Union, with the dynamic towards an uncertain final destination built into it. It was also a result of the obvious fact that the EU simply did not have something that could be called a 'democracy and human rights *acquis*'. The vague formulae of the Copenhagen conditions did not refer back to a specific set of detailed legal rules and policies about what counts as 'democracy, the rule of law, human rights and respect for and protection of minorities' within the Union for the simple reason that such a set did not exist.[30] The vagueness of the formulaic conditions was a consequence of the lack of powers and policies of the Union in these fields. The Copenhagen conditions were all there was.

The Charter may be viewed as a partial solution to the 'double standards' and 'moving target' problems. By 'codifying' rights within the Union, it extends to the current Member States the rights regime that had been used externally (hence the solution to the double standards problem), and petrifies, or freezes, the understanding of the minimal yardstick of human rights within the Union (hence the solution to the moving target problem). Naturally, this is only a partial and very imperfect solution. As to the double standards problem, the final clauses of the Charter make it fairly plain that the Charter applies to the Member States only when they are implementing Union law.[31] By contrast, human rights conditionality, as reflected, for example, in the annual reports of the Commission on candidate states' progress towards accession, scrutinised a broad spectrum of political and legal matters in candidate states, regardless of whether these matters could be characterised as 'implementation of EU law'. As to the 'moving target' problem, the characterisation of the Charter's function as 'freezing' the understanding of human rights is a wild exaggeration. The vague, open-ended wording used by the Charter (as, unavoidably, by any constitutional charter) clearly lends itself to a dynamic, changing interpretation by the

[29] Sadurski above n 10 at 346.
[30] See H Grabbe, 'Will EU Membership Improve Governance and the Quality of Democracy in Central and Eastern Europe?' (unpublished manuscript, copy on file with the author, 2003).
[31] Art 51 (1) of the Charter.

judicial and political branches. So, in both these regards, we are talking about a difference of degree rather than a qualitative leap; but differences of degree matter, and as a matter of degree, the Charter *does* reduce both the external-internal human rights scrutiny gap, and the uncertainty produced by evolving admission criteria.

I do not wish to claim that this consideration actually motivated the main players involved in the drafting of the Charter. But some have made such a claim. George Bermann has said:

> I certainly view the Charter of Fundamental Rights project as … having been pursued in large part in consideration of the EU's prospective enlargement and therefore rightly counted as among the Union's legal response to enlargement. This is not to say that human rights protection did not need to be fortified throughout the Community generally, or that the Charter project would not have been pursued but for the prospect of eastward enlargement. But that prospect furnished an important impetus.[32]

It certainly makes good sense to connect the Charter and enlargement in this way, but it is not obvious that, as a matter of the actual process of drafting and preparing the Charter, the enlargement factor played any significant role, at least at the level of subjective motivations of the Charter drafters and the main players involved in the Charter process.[33] The Cologne summit of June 1999 announced that the main motive for launching the Charter project was the perception that the protection of fundamental rights — and its visible symbol in the form of a Charter — is an indispensable factor of the EU's legitimacy *within* the existing borders of the Union. The summit expressly drew a link between the protection of fundamental rights and the legitimacy of the Union, but with an eye on the public in the Member States, not the applicants.[34] And yet, regardless of the subjective motivations of those who launched the Charter project, and those who pursued it up to the Nice summit, the objective function of the Charter has been, among other things, to facilitate enlargement by reducing the above-noted problems related to human rights conditionality. And this is not just sheer

[32] G Bermann, 'Law in an Enlarged European Union' (2001) 14 *European Union Studies Association Review*, Summer 2001 <http://www.eucenters.org/bermann.html> (1 December 2003).
[33] See Sadurski, above n 10 at 346–48.
[34] The conclusions of the Cologne summit of 3–4 June 1999 declared that '[p]rotection of fundamental rights is a founding principle of the Union and an indispensable prerequisite for her *legitimacy*', and that '[t]here appears to be a need … to establish a Charter of fundamental rights in order to make their overriding importance and relevance more visible *to the Union's citizens*': European Council Decision on the Drawing Up of a Charter of Fundamental Rights of the European Union, Annex IV to Conclusions of the Cologne summit, available at <http://db.consilium.eu.int/df/default.asp?lang=en> (1 December 2003) (emphases added).

speculation; at least some applicant states ascertained the benefit of the Charter in precisely this way.[35]

THE SOVEREIGNTY CONUNDRUM AND THE CHARTER

The conventional wisdom, heard so many times in the discussions regarding the eastern enlargement of the European Union, has it that the process of accession has cruel irony to it. Countries with a proud national history, which have only just emerged from several decades of humiliating and oppressive domination by the Soviet Union (at worst being subjected to forceful integration into Soviet statehood as in the case of the Baltic states), and at best suffering all the burdens and disadvantages of 'limited sovereignty', are now about to embark upon the surrender their sovereignty again, this time for an admittedly benign foreign body, but a foreign body nevertheless.[36] This statement which, for the sake of brevity, I will be referring to as the 'sovereignty conundrum' has been formulated in many variants and versions, both within and outside the Central and Eastern European states, and not necessarily by those who are hostile to accession. Rather, it has a value-neutral character, merely drawing attention to a certain historical irony, or a major problem to be solved. It also points to a possible, albeit partial, explanation for the relatively low support for accession found in at least some of the accession states[37] and for the popularity in those countries of certain anti-EU political movements which use the slogan: 'We have just got rid of Moscow's domination and are about to subject ourselves to domination by Brussels.' One does not have to accept all the demagogic content of these slogans in order to appreciate why they may strike a sympathetic chord with a large segment of public opinion. If

[35] An official document of the Polish Ministry for Foreign Affairs entitled 'The Treaty of Nice: The Polish Point of View,' in the section devoted to the Charter of Fundamental Rights, states: 'The Charter places difficult challenges in front of the candidate-states, but at the same time, it … renders the procedures of accession to the EU more transparent and the assessments [of whether a candidate state meets the accession criteria] — more predictable.' Jan Barcz *et al* (eds), *Traktat z Nicei: Wnioski dla Polski* (Warsaw, 2001) 208. A similar view was expressed in the first Polish book-length commentary on the Charter, S Hambura and M Muszyński, *Karta Praw Podstawowych z komentarzem* (Bielsko-Biala, Studio Sto, 2001) at 229.

[36] See, eg J Habermas ('In [Central and Eastern European] countries there is noticeably little enthusiasm for the transfer of the recently won rights of sovereignty to European level'), 'So, Why Does Europe Need a Constitution?' *Robert Schuman Centre* (Policy Papers, Series on Constitutional Reform of the EU, 2001–02) <http://www.iue.it/RSCAS/e-texts/CR200102UK.pdf> (1 December 2003) at 7; A Nikodém, 'Constitutional Impact of the Eastward Enlargement in Central-Eastern Europe. Report on Session III' in Kellermann *et al*, above n 25 at 377.

[37] In late 2002, in three accession states in CEE (Estonia, Latvia and Slovenia), a majority of people did not think that their country's accession would be 'a good thing': see 'Candidate Countries Eurobarometer 2002: First Results' <http://europa.eu.int/comm/public_opinion/archives/cceb/2002/cceb_2002_highlights_en.pdf> (11 February 2003).

this is the case, it may both weaken the legitimacy of the new states' accession (by depriving the pro-European elites in those countries of strong social support) and, in the post-accession period, weaken those states' commitment to supranationalism, the Community method, and a bona fide observance of the Union's rules. At any rate, such an argument can be made, and it does not sound wildly implausible.

Sovereignty Conundrum and Nationalism

Like every piece of conventional wisdom, the sovereignty conundrum (again, understood as a purely descriptive statement, without either endorsing or refuting the sentiments that it describes) has a rational core to it but also builds upon a degree of misperception of the attitudes dominant in the accession states. Let me begin with the rational core. It is not just that the citizens of post communist states of Central and Eastern Europe have a special desire for something of which they have been deprived for so long, and that their embrace of a strong sovereignty principle was a natural reaction to decades of forceful denial, or at least very drastic limitation of, sovereignty. The causes for the celebration of sovereignty of a nation-state go deeper than that. After the fall of Communism, national identity (often perceived in an ethnic rather than civic fashion) has been either the only or the most powerful social factor, other than those identified with the social foundations of the *ancien régime,* capable of injecting a necessary degree of coherence into society and of countervailing the anomie of a disintegrated, decentralised, and demoralised society. An expectation, expressed especially in the 1970's and 1980's by the fledgling democratic opposition in some of these countries (in particular, Poland, the then Czechoslovakia and Hungary), that 'civil society,' constructed on the basis of the rules of social solidarity, responsibility and strong informal networks constituting the intermediate structures between the state and the family, would play the role of such unifying, anti-anomie forces, turned out to be little more than wishful thinking. In some of these societies (particularly in Poland) the dominant religion played such a role to a limited degree and for a limited period of time, but it faced its own problems on account of its need to reconstitute its social role in a situation in which it no longer constituted the only free political space in an otherwise unfree society. So virtually the sole common force capable of supporting the social coherence required for state building after the fall of communism was a national idea feeding itself largely on the ideal of sovereignty of the nation-state.[38] As Claus Offe has noted: 'The sheer

[38] Of course, the link between nationalism and celebration of sovereignty is contingent; the national idea (even in its strong forms) can thrive without, or even against, the context of a sovereign state. But in countries such as Poland or the Baltic States where the memories of the

absence of imagined as well as institutionalised collectivities such as classes, status groups, professional or sectorial associations, constituted religious groups, etc, moves the ethnic code into a prominent position.'[39]

It is easy (and often, it is more than justified) to discredit the national idea as xenophobic, primitive, and with a built-in potential to degenerate into a rationale for violence against the 'other'. The unwholesome picture of the virulent aspects of nationalism in Central and Eastern Europe after the fall of Communism, ranging from open discrimination against Russians in newly liberalised Baltic states, through the 'velvet divorce' of Czechoslovakia, and ending with brutality towards the Roma throughout the region, show the pathological excesses of nationalism in that arena. But this does not discredit the descriptive claim that nationalism was an indispensable factor in providing the basis for societal mobilisation without which the processes of state building and state transformation would not have occurred, or would have been even less successful than they were. Since all these countries committed themselves, at least in declarations, to democratic state building or transformation, a 'national' idea (sufficiently contained and domesticated, of course) proved to be an indispensable factor in the democratisation effort after the fall of communism in the region. Since the ideological factors presupposing a strong civil society are largely missing in there, it is no wonder that it was a by-and-large ethnic variation of nationalism which often provided the support for state building. As a Hungarian scholar puts it succinctly: 'Post communist states cannot escape becoming nation-states because the community and homogeneity necessary for the functioning of a state will be based on ethnic community'[40]

This confirms the analysis that John Breuilly develops in his study of the relationship between nationalism and the modern state.[41] Breuilly identifies three main functions of nationalist ideologies vis-à-vis the state which render nationalism a particularly effective component of political action: those of coordination, mobilisation and legitimacy.[42] The mobilisation function is of particular relevance in our context. While Breuilly carefully emphasises that the general process of mobilisation in the modern state does not necessarily give rise to nationalistic politics, especially when different social groups find effective ways of expressing their interests to government, nevertheless in circumstances where civil society is poorly articulated and

loss of sovereignty are strong, the two happen to come in a package. I will return to this point below.

[39] C Offe, 'Ethnic Politics in European Transitions' *Universität Bremen* (working paper of Zentrum for Europäische Rechtspolitik an der Universität Bremen, Bremen February 1993) at 26 (footnote omitted).
[40] A Sajo, 'Protecting Nation States and National Minorities: A Modest Case for Nationalism in Eastern Europe' (1993) *University of Chicago Law School Roundtable* 53 at 53.
[41] J Breuilly, *Nationalism and the State* (New York, St. Martin's Press, 1982) at 349.
[42] *Ibid* at 365–73.

where the representation of social interests by parties based on class or special interest is either blocked or underdeveloped, nationalism becomes a convenient device of political mobilisation.

This is precisely the case in post communist societies, and the words written by Breuilly about colonial situations apply equally well to post communist Central and Eastern Europe: 'In such cases the appeal to cultural identity is often a substitute for the failure to connect politics with significant social interests....'[43] Furthermore, it needs to be remembered that a significant number of the accession states are, literally speaking, 'new' states (all three Baltic states, the Czech Republic, Slovakia and Slovenia). It is natural and understandable, even if deplorable, that 'new states' make a strong appeal to national identity, both as a way of asserting their legitimacy in the international order and of matching a new territorial polity to an ideology which provides the necessary degree of coherence and mobilisation to make a new political elite sufficiently comfortable. It is also in the new states that nationalist movements — often in opposition to a dominant elite — have found particularly fertile ground for development, due to there always being a degree of territorial-ethnic mismatch inherited from the older state. These movements push the dominant elite into a more nationalistic policy, often despite itself.[44]

The sovereignty conundrum is thus actually stronger than its conventional articulation would suggest, producing a large irony. On the one hand, the prospects of accession are rightly seen as related to the consolidation of democratic institutions in candidate states. On the other hand, the robustness of new democracy in these countries relies partly on the nationalistic idea which itself is in tension with the accession. I use the word 'tension' rather than 'conflict' advisedly since, in the end, there need not be any irreconcilable conflict between membership in the EU and preservation of strong national and ethnic identity, centred or not around traditional nation-states.

Indeed, it is not obvious that nationalist ideas will inevitably be hostile to supranational authority, and more specifically toward the dissolution of nation-state authority within a web of overlapping networks of authorities within the EU. Under some circumstances, especially when national claims are made from within a cultural-national perspective of a state which fails to encompass the entire ethnic nation concerned, nationalist feelings may favour supranationalism as a means of transcending a nation-state framework, seen as incapable of properly capturing the cultural space of a nation, and when at the same time a dream of a 'larger' nation-state has been abandoned as unrealistic. The transfer of a part of sovereign authority to the

[43] *Ibid* at 371.

[44] 'It is in the new state rather than in the colonial state that cultural identity becomes a way of justifying political opposition to the state, often a state which itself claims to define and express national values,' *ibid* at 374–75.

supranational level, on the one hand, and the regional level, on the other, may be seen as conducive, rather than hostile, to the exercise of nationalistic cultural, linguistic and social claims.

János Kis describes the interesting development of certain strands of Hungarian nationalist conceptions in recent years. In the late 1970s, Hungarian minority cultures were rediscovered outside the Hungarian state, and an attempt was made to reintegrate them into the general culture of the Hungarian nation.[45] This rediscovery by Hungarian populist intellectuals, Kis recounts, took several forms, one of which was to adopt the language of minority rights and democracy in order to defend the Hungarians in Romania, Slovakia and Serbia against oppression and forced assimilation. After the fall of Communism, and especially after the government had set the goal of entering the EU as a key strategic target, some populist nationalists embraced the idea that the 'Hungarian question' could find a proper resolution within the EU rather than within the existing structure of nation-states in central Europe. In the words of Kis, 'the downgrading of the sovereign state and the upgrading of the regions below it, with a capacity for crosscutting state boundaries, might bring the problem of the Hungarians close to a solution.'[46]

The story that Kis tells is instructive because it cautions against taking for granted a relationship between nationalism and a strong endorsement of nation-state sovereignty. Still, it does not fully dispose of the irony just noted with regard to the role of nationalism which, while central to the process of state building also disrupts moves towards EU accession. For one thing, as Kis himself admits, his story is just part of the picture of Hungarian nationalism. There are also those on the national right who are ideologically hostile towards supranationalism. Second, the alliance of nationalism with pro-EU sentiment is purely strategic and instrumental rather than principled. Third, this alliance is supported by conditions which are not present in many other candidate states. For instance, in Poland, a country in which concern for the fate of Poles living in neighbouring states has never weighed very heavily on the ideology of the nationalist right (certainly, not as much as in the case of Hungary), the idea that EU supranationalism may be a means of building linkages with Poles in Lithuania (much less, in Ukraine, Belarus or Russia, for whom EU membership is not on the horizon) simply has not registered in the ideological discourse about nationalism and sovereignty. So the tension just identified, between nationalism and the dissolution of sovereignty with the EU, is real and it needs to be taken into account when discussing the sovereignty conundrum.

[45] J Kis, 'Nation-Building and Beyond' in W Kymlicka and M Opalski (eds), *Can Liberal Pluralism be Exported? Western Political Theory and Ethnic Relations in Eastern Europe* (Oxford, Oxford University Press, 2001) 220–42 at 232–39.
[46] *Ibid* at 239.

On the other hand, there are some factors which weaken, rather than amplify, the sovereignty conundrum insofar as it poses a problem for the smoothness of the accession process. For one thing, in the debates on accession within candidate states, the question of sovereignty has more often been raised by politicians hostile to the EU than by the population at large. The concern about losing sovereignty is not something that dominates Eurosceptic public opinion.[47] Among the factors which trigger anti-accession views, socio-economic factors (ie a cold calculus of benefits and costs) are far more important than emotional and symbolic sovereignty issues.[48] If one follows public debates in the media, one will find that EU-hostile pronouncements are usually based on a feeling that certain groups (such as farmers) will be unfairly treated under the transitional rules, that social and economic dislocations will be too harsh, or that some countries may even become net contributors to the EU rather than net beneficiaries. A highly symbolic concern about the prospect of a loss of sovereignty is very much in the background, and much more visible or rather audible, in politicians' speech than in people's minds.

There are a number of reasons for this. First, concerns about the loss of sovereignty have been long associated in the accession states with a fear of an aggressive, military neighbour, often an occupant, and 'Brussels' simply does not fit this image. In this region, at least, you 'normally' lose your sovereignty to a violent, military aggressor who takes it away from you, not to a benign grouping of states whom you invite to take it from you (however misplaced, in the eyes of the critics, such an invitation may be). Indeed, the contrast between the old fear of the USSR (or Germany) and the traditionally positive, often lyrical, myth of Western Europe, is capable of rendering the EU-related sovereignty fears unreal and ridiculous.[49] Second, the EU is widely perceived in Central and Eastern Europe as not much more than a free-trade organisation, a little bit like the old European Economic

[47] See for example the public opinion survey of January 2003 in Poland, which concerned the motives for approval or rejection of accession to the EU. Among those who intend to vote against accession in the referendum, the danger to national sovereignty was ranked number four among the reasons produced for such a preference. Above it were fears related to the domination of foreign capital, bad effects upon agriculture and the lack of preparedness of Poland for integration, see 'Motywy poparcia lub odrzucenia integracji: Komunikat z badań' Centrum Badania Opinii Spolecznej, Warsaw January 2003 (unpublished manuscript on file with the author) at 4.

[48] *Ibid* at 4.

[49] Stephen Whitefield and Geoffrey Evans conclude, on the basis of their analysis of surveys in CEE countries that attitudes towards 'the West' in those countries are usually not motivated by concerns about national independence. To the extent to which concerns about national independence and patriotism are strong, they are usually related to near neighbours (eg nationalist attitudes in Hungary are focused on the fate of ethnic Hungarians in neighbouring

Community (EEC) or current European Fair Trade Association (EFTA). The reality of the degree of supranational political phenomena and of the political authority vested in supranational bodies has not been registered by many people in the region, apart from a handful of experts. Thus while, on the one hand, traditional approaches to national sovereignty still dominate,[50] on the other hand, the popular perception of the EU simply does not threaten those approaches.

Also playing a role are doctrinal constructions of sovereignty within the EU, and the fate of the sovereignty of candidate states once they enter the Union. To be sure, this role must not be exaggerated. Constitutional legal scholars have a very limited impact upon public discourse in general, and whatever legal constructions of sovereignty they come up with may affect public perceptions only to a limited degree. But constitutional scholarly works have a slow and indirect, but steady, impact upon the way in which sovereignty is constructed within the political class, and in society at large. It is therefore important to look at the dominant views within legal-constitutional scholarship about what happens to the sovereignty of the Member States within the EU.

As a representative example of doctrinal approaches to sovereignty in the context of the impending EU membership, we may take Polish constitutional doctrine. My reading of Polish scholarship in the field convinces me of the clear dominance of theories which deny the 'loss of sovereignty' thesis and which therefore define the sovereignty conundrum out of existence. They all try to reconcile (1) the traditional discourse of sovereignty with (2) the realities of the EU and with (3) the thesis that no loss of sovereignty will occur after accession. One would think that a combination of these three elements is unlikely; after all, both the range of powers exercised by the EU and the relationship between the EU and national institutions support Bruno de Witte's suggestion that 'the European Community cannot easily be integrated within the traditional account of popular sovereignty.'[51] And yet it seems to come quite naturally to Central European constitutional scholars, especially when they invoke the language of the relevant constitutional provisions.

countries; nationalism in Baltic states is concerned about relations in Russia and Russian-speakers in those countries, etc) rather than to Western Europe, see S Whitefield and G Evans, 'Attitudes towards the East, Democracy, and the Market' in J Zielonka and A Pravda (eds), *Democratic Consolidation in Eastern Europe*, vol 2 (Oxford, Oxford University Press, 2001) 231-53 at 248–49.

[50] See A Albi, 'Postmodern Versus Retrospective Sovereignty: Two Different Discourses in the EU and the Candidate States?' in N Walker (ed), *Sovereignty in Transition* (Oxford, Hart Publishing, 2003).

[51] Bruno de Witte, 'Sovereignty and European Integration: the Weight of Legal Tradition' in A Slaughter, A Stone Sweet and JHH Weiler (eds), *The European Court and National Courts — Doctrine and Jurisprudence* (Oxford, Hart Publishing, 1998) 277–304 at 281. Elsewhere, de

Typically these constructions rely upon a distinction between 'sovereign powers' (or 'sovereign authority') of a state and 'sovereignty' itself.[52] Some commentators, especially those inclined towards international law, emphasise that any international treaty consists of a surrender of some sovereign rights, but that this is in itself an exercise of sovereignty. In this respect, the EU is not seen to be qualitatively different from other international organisations. There may be a difference in the extent of the powers delegated to the EU, but this is usually dismissed as being merely a matter of degree. The upshot of these theories is that the states simply 'delegate' to the EU some of their sovereign rights but not their sovereignty itself. In the words of one scholar, 'sovereignty is not lost as a result of the process of integration [within the EU].'[53]

In Poland, as in some other accession states, these doctrinal constructions parallel the language of the national Constitution which provides a special ratification procedure for those international treaties as a result of which Poland 'transfers the competencies of state organs in some matters to an international organisation or an international body' (Article 90 (1)).[54] On that basis, doctrine can easily conclude that the 'Constitution guarantees the keeping of sovereignty by the Polish state in the integration processes'.[55] As a leading Polish legal scholar claims, the constitutional formulation

Witte asks whether it has not become an artificial contrivance to explain the operation of the European Union institutions as the 'common exercise of State sovereignty,' when we know that important decision-making powers are exercised by the Commission and the European Parliament, who operate independently from the states, and that the Council itself increasingly decides by qualified majority, so that a particular state can be outvoted?' (B de Witte, 'Constitutional Aspects of European Union Membership in the Original Six Member States: Model Solutions for the Applicant Countries?' in Kellerman *et al* above n 25 at 79.

[52] See eg A Raczynska, 'Reinterpretacja pojecia suwerennosci wobec czlonkostwa w Unii Europejskiej' (2001) 1 *Przeglad Europejski* 95 at 113–14, and the various sources quoted there.
[53] *Ibid* at 115.
[54] Similar is the wording of the corresponding provisions of many other 'accession states' constitutions in CEE; for a useful compilation and discussion, see A Albi, 'The "Souverainist" Constitutions of the Eastern European Applicant Countries with a View to EU membership' (unpublished manuscript, 2002, copy on file with the author) Table 2. A similar construction has been adopted among most other Member States of the European Communities; most of them had adopted, in the words of de Witte, 'th[e] cautious approach — accommodation of the principle of sovereignty to the needs of international cooperation, but preservation of its existence': B de Witte, 'Sovereignty' above n 51 at 282. De Witte distinguishes between the two models: the Belgo-German formula which allows for *attribution of powers* to international organisations or transfers of sovereign rights, and the Franco-Italian formula which expressly allows for *limitations of sovereignty*; the only constitution using both these formulas being the Greek Constitution: *ibid* at 282–4. De Witte warns against attaching any special importance to the distinction between the 'transfer' and the 'limitation' formula because, as he says, 'in the case of the European Communities, the limitation of sovereignty has been accompanied by the attribution of powers to international institutions, and those two operations are inseparable' (*ibid* at 284).
[55] J Barcz, 'Akt integracyjny Polski z Unia Europejska w swietle Konstytucji RP' (1988) 4 *Panstwo i Prawo* 3 at 8.

implies that: (a) there is a constitutional ban on the transfer of the 'totality' of state powers; (b) even within the matters transferred, what is being surrendered is the monopoly of state power, but the state nevertheless maintains some powers with regard to these matters; (c) the transfer is not absolute and not irrevocable.[56] (Indeed, an earlier draft of this constitutional provision stated said that what is being transferred is the 'execution' of some state competencies, and not the competencies themselves. While the distinction between the 'execution of competencies' and the competencies per se was eventually abandoned, the doctrine explains the abandonment of this formula as for 'linguistic reasons only' and attaches no significance to it in the minds of the constitution makers).[57]

In conclusion, legal constitutional scholarship in the accession states is working hard to reconcile the state-focused discourse of sovereignty with the legal realities of the EU accession, and in so doing it constructs a legal fiction whereby the transfer of some, even crucial, powers to the supranational level does not amount to a transfer of sovereignty, but only to a transfer of the exercise of some sovereign powers.[58] The post-sovereign, cosmopolitan position[59] has not yet made any meaningful inroads into scholarly, or political discourse.[60] But, in view of my earlier remarks about the role of nationality in post-communist transformation, this is not surprising, nor even necessarily such a bad thing, because it allows scholarly discourse to stay in reasonable proximity to societal views and expectations.

[56] *Ibid* at 9.

[57] *Ibid* at 9. But, in fairness, I should add that the same author characterised the 'traditional point of view … that membership of a state is in conformity with the state and national sovereignty and with political independence' as 'ever less intelligible and less convincing' and urged reconsideration of the concept of sovereignty in the light of EU integration processes, see J Barcz, 'Suwerennosc w procesach integracyjnych' in W Czaplinski (ed), *Suwerenność i integracja europejska* (Warsaw, Warsaw University Centre for Europe, 1999) at 35. Similarly, M Wyrzykowski called for a 'new, modern approach to the problem of sovereignty' and deplored 'recourses to a false understanding of the concept of sovereignty', the one 'rooted in the past already gone': M Wyrzykowski, 'Klauzula europejska — zagrozenie suwerennosci? (suwerennosc a procedura ratyfikacyjna czlonkostwa Polski w UE)' in Czaplinski (above), 85–96 at 96. Another scholar notes that, in view of the ECJ jurisprudence which grounds the rule of primacy of community law over domestic laws, 'de facto decision-making by the [European] Union will deprive the concept of sovereignty of its real contents' and that the absolute primacy of Community law over national constitutions will lead to 'the erosion of the concept of national sovereignty': K Wójtowicz, 'Suwerennosc w procesie integracji europejskiej' in Waldemar Jan Wolpiuk (ed), *Spór o suwerennosc* (Warsaw, Wydawnictwo Sejmowe 2001) 156–76 at 173–4.

[58] I hasten to add that scholarship and doctrine in accession countries is not alone in having recourse to such fictions; for an account of 'the traditional legal fiction that, when the European Community institutions exercise their powers, they are, constitutionally speaking, acting on behalf of the sovereign peoples of the Member States' as propounded in France, see de Witte, 'Sovereignty', above n 51 at 296.

[59] See Albi, above n 50.

[60] Though some legal scholars make *critical* statements about the persistence of false, obsolete concepts of sovereignty, see Wyrzykowski, above n 51 at 96.

While the attachment to traditional notions of sovereignty by legal scholars is best explained by their intellectual conservatism, a positive side effect of this is that they do not cut themselves off from dominant social attitudes and do not lose the capacity to exert effective political influence. In this way, constitutional-legal scholarship may play a useful legitimating role. It may yield the legitimating theories which will reconcile the divergent pressures encapsulated in the sovereignty conundrum, namely. The pressure towards — accession to the increasingly supranational EU, on the one hand, and the pressure to adhere to traditional and deeply cherished notions of sovereignty, on the other.

Rights, the Charter, and Public Concerns about Sovereignty

The upshot of the argument thus far is that sovereignty conundrum poses both a greater and a smaller problem for enlargement than the conventional view would have it. On the one hand, there are factors which amplify its gravity, notably the natural appeal to nationalism as a rational device for mobilising state building and state transformation processes, especially in the circumstances of new states. On the other hand, other factors weaken the possible impact of the sovereignty conundrum upon the smoothness of accession. These include the image of the EU as a benign, rather than sovereignty-threatening, power; the perception of the EU as just another international organisation; and the legitimating effects of the scholarly construction aimed at reconciling the traditional notion of sovereignty with the legal consequences of accession to the EU.

The two last mentioned factors will not last forever, however. Sooner or later, there will come a 'reality check' both for general public opinion and for legal scholarship (as well as for political elites in the intersection between national government and the EU). It will become plain that the EU is just not like any other intergovernmental entity and that accession to it is not like a ratification of any other international treaty. On the contrary, sticking to traditional constructions, according to which Member States retain sovereignty notwithstanding a 'transfer of some sovereign competencies', will ring increasingly hollow. One cannot build long-term prospects for the legitimacy of accession to the EU on perceptions which are unlikely to survive accession's reality.

My claim is that the constitutionalisation of rights in the EU has the potential to overcome the sovereignty conundrum. If there is one domain in which concerns over national identity and accompanying notions of sovereignty are obviously weak in Central and Eastern Europe, it is in the area of protection of individual rights, both civil-political and socio-economic. The reasons for this are only too evident. The legacy of Communism under which individual rights were systematically trampled on is still fresh in

many people's minds. In those days, 'intervention' from outside — from sources ranging from official state policy (eg, under the Carter administration), through NGO actions (such as Amnesty International, on the Helsinki Committee), and ending with foreign journalists reporting on human rights abuses in the USSR and its satellite states — was uniformly condemned by the governments of the region as 'interference in internal affairs' while being applauded by the citizens of these states. Hardly anyone (other than those acting in an official capacity) took umbrage at such intervention as offending national identity. Indeed, it was often perceived as the only source of hope in an otherwise grim picture. This general predisposition to applaud 'foreign interference' in human rights affairs has been, after the fall of Communism, further amplified by a general social frustration about the everyday practice of rights protection in newly democratised states. Against by-and-large satisfactory constitutional charters of rights, there is a much less impressive practice of administrative non-compliance, and a slow and under-resourced system of justice.

This explains why the Strasbourg Court has been such a great success in the minds of the general public.[61] Even though actual decisions by the European Court of Human Rights (ECHR) in cases from Central and Eastern Europe are few and far between,[62] the Strasbourg Court occupies a very high position in the pantheon of European institutions as perceived by the citizens of those states.[63] The European Convention system has already affected the sovereignty of European states in multiple ways. It has provided individuals with direct access to an independent European body to complain about their own governments. Domestic courts (both constitutional and 'ordinary') have absorbed the ECHR case law. Legislatures and executives of the Council of Europe Member States have had to align their laws and policies with ECHR case law. And specific ECHR rulings have been implemented by the Member States.[64] No serious objections to these 'violations of sovereignty' by the Strasbourg Court have ever, to my knowledge, been raised in the states of the region. On the contrary, at the level of civil society, the Strasbourg Court often functions as the forum of last resort

[61] One partial measure of this success was the number of applications to the Court. Between November 1998 and 1 September 2000, the Court received 6847 applications from 17 CEE states, which constituted 41% of all applications registered in that period (41 states are members of CoE), see J Schokkenbroek and I Ziemele, 'The European Convention on Human Rights and the Central and Eastern European Member States: an Overview' (2000) *Nederlands Juristenblad* 1914 at 1917.

[62] See R Harmsen, 'The European Convention on Human Rights after Enlargement' (2001) 5 *International Journal of Human Rights* 18 at 28.

[63] Harmsen correctly assesses that 'expectations of what may be accomplished through the Strasbourg system appear to run comparatively high in the [CEE countries],' *ibid* at 27.

[64] For an overview of the main forms and areas in which participation in the ECHR system has produced important changes in CEE legal systems, practices and institutions, see Schokkenbroek and Ziemele, above n 61.

for those who allege violation of their rights, and its emotive and symbolic significance in public imagery is unequivocally positive. Strasbourg has therefore already made some inroads into state sovereignty via the human rights path.

The role of the ECHR system in legitimately providing remedies for faulty individual rights protection systems is admittedly limited. This is for both procedural reasons (eg the requirement of the exhaustion of national remedies in states whose remedies are extremely inefficient is in itself, well, exhausting) and substantive reasons (considering the limited scope of the rights that the ECHR protects). The Convention thus has a very limited potential for becoming a significant part of the constitutional system of the state's party to the ECHR, in the thick and broad sense of the term 'Constitution'. This is not to deny the status of the ECHR or of Strasbourg jurisprudence as law in a sense which goes well beyond a traditional, intergovernmentalist understanding of international law.[65] But it is not fully *constitutional* law in the sense of a polity-defining body of norms, and the ECHR is more of an international than a constitutional court.[66] Indeed, there has been a debate lately about whether the ECHR should assume a more 'constitutional' mantle, for example by elucidating the general principles upon which it bases its decisions rather than continuing its case-by-case approach. Interestingly, it is precisely the enlargement of the Council of Europe with new members from Central and Eastern Europe that provided at least some of the participants in this debate with the direct impulse to make this suggestion.[67]

Moreover, the strictness of the 'conditionality' applied by the Council of Europe in considering applications for membership has often been relatively low, partly because after the fall of Communism members of the Council of Europe perceived the benefits of embracing post communist states as outweighing the problems related to their non-compliance with ECHR standards. As one commentator notes, '[t]he West may have wasted leverage by hastily offering membership in the Council of Europe.'[68] Several critics have deplored the lowering of standards of the Council of Europe accompanying its own enlargement from 23 in 1989 to 43 in 2001.[69] In effect, some noted the danger of 'double standards', albeit one that is the

[65] See RS Kay, 'The European Human Rights System as a System of Law' (2000) 6 *Columbia Journal of European Law* 55. Kay analyses ECHR law from the point of view of Hart's concept of law and draws conclusions about its law-like character mainly on the basis of the 'internal' attitude displayed in the compliance of states with the Strasbourg Court's decisions.
[66] See M Shapiro and A Stone, 'The New Constitutional Politics of Europe' (1994) 26 *Comparative Political Studies* 397 at 411.
[67] See Harmsen, above n 62 at 32–37.
[68] KE Smith, 'Western Actors and the Promotion of Democracy' in J Zielonka and A Pravda (eds), *Democratic Consolidation in Eastern Europe* vol 2 (Oxford, Oxford University Press, 2001) 31–57 at 43.
[69] For a discussion of some of these critiques, see Harmsen, above n 62 at 19–22.

reverse of the one observable in EU human rights policy (as discussed in Part I of this chapter), with the new Member States of Council of Europe being judged by *less* stringent standards than their Western European counterparts.[70]

The situation of the EU Charter of Fundamental Rights is quite different. The Charter has the canonical form of a standard constitutional charter of rights,[71] and will soon be incorporated (in one form or another) into a constitutional treaty of the Union. It is comprehensive, in the sense of incorporating, while going far beyond the strength and the scope of rights protected by, the ECHR.[72] Finally, there is no expectation that the Charter will be applied less stringently to the new, as compared to the old, Member States of the EU, thus becoming a mere 'educative' rather than a constitutional document.

The crux of my argument is that, as the process of European constitution making progresses and embraces a full-fledged Charter of Fundamental Rights, the sovereignty conundrum can be largely overcome. This is due to a combination of two salient factors. First, while the EU's rights dimension may still be largely invisible to the general public of the accession states, there is a potentially positive, receptive attitude in those countries for strong external scrutiny of constitutional rights implementation. If the EU comes to be perceived in this way, its prestige will be strengthened and misgivings related to the sovereignty conundrum will weaken. Second, there is a high degree of congruence between the structure of constitutional rights in the post communist candidate states of Central and Eastern Europe and the structure of rights as displayed in the EU Charter.[73] Note that the combination of these factors, rather than each taken separately, is necessary to make the argument about overcoming the sovereignty conundrum work. The first, taken on its own, could apply to any external human rights scrutiniser, including the UN Commission on Human Rights, the US Congress or the ECHR. The second factor, taken on its own, merely suggests that the accession states will have no problems accepting the Charter because they will recognise in it much of their own constitutional design. But when combined, these factors suggests a recipe for overcoming the conundrum,

[70] See Harmsen, above n 62 at 30.

[71] See N Walker, 'The Charter of Fundamental Rights of the European Union: Legal, Symbolic and Constitutional Implications' in PA Zervakis and PJ Cullen (eds), *The Post Nice Process: Towards a European Constitution* (Nomos, Baden-Baden, 2002) 119–28 at 125 (stating that 'the Charter as drafted already bears all the hallmarks of a legal instrument' and that it 'is designed 'as if' it could have proper legal effect' (footnote omitted).

[72] The Explanatory Notes of the EU Charter list 12 Articles of the EU Charter (out of 50 substantial right Articles) which have equivalents in the ECHR, and additionally four Articles where the EU Charter provides more extensive protection than the equivalent right in the ECHR. A very rough and imprecise count would suggest that the ECHR coverage constitutes around 30% of the EU Charter's coverage.

[73] For an argument supporting this point, see Sadurski, above n 10 at 349–59.

for the simple reason that individual rights are a natural and generally accepted inroad into the national feelings which tend to feed traditional conceptions of sovereignty, while constitutionalism provides for a process by which a given polity can define an identity on its own terms without necessarily resorting to hostility-engendering notions of otherness. A smooth absorption of the constitutional identity of new Member States (insofar as their constitutional rights are concerned) into a broader constitutional identity of the EU offers hope for overcoming the sovereignty conundrum as a possible obstacle to enlargement, which would then not threaten the further deepening of the political union, as many EU observers fear.

The parallelism between the constitutionalisation of rights in the EU and the enlargement of the Union opens up a possibility for the EU to be seen, alongside its many other legitimating dimensions, as an important human rights actor in the eyes of politicians, legal scholars and the general public in the accession and Member States alike. The fact that the EU has massively taken on board the issue of human rights at about the same time as its eastward enlargement offers an opportunity for combining the two in a way which is more than just chronological but also functional and legitimising. It is functional, in the sense of supporting the EU's vocation for ensuring respect for and implementation of specific human rights, and not merely paying lip service to some fundamental principles proclaimed in Article 6 (1). It is legitimising because its very effectiveness in playing this role will contribute importantly in building prestige, authority and ultimately political legitimacy in the eyes of the general public, even in those societies which experience the sovereignty conundrum.

I do not claim that a more human-rights-friendly EU is necessarily a Union closer to citizens everywhere. It may be, as Joseph Weiler has argued, that in states which do not suffer from rights deficits, adding rights at the supranational level may have the effect of putting more distance between individuals and the Union, rather than bringing them closer.[74] My argument is specific to the post-authoritarian societies of Central and Eastern Europe. A saturation with rights is emphatically *not* part of the collective memories of these societies, or of their present dominant perceptions, and identification of the EU as another layer of possible rights protection is highly likely to strengthen its legitimacy in the eyes of the general public.

The EU is not yet perceived by public opinion in the accession countries as an entity with a high degree of relevance to individual rights.[75] Rather, it

[74] JHH Weiler, *The Constitution of Europe* (Cambridge, Cambridge University Press, 1999) at 334–35.

[75] This contrasts with the views of some legal scholars in CEE; an article co-authored by a leading Polish expert in EU law claims that 'the mechanisms established on the basis of the

is seen even by proponents of accession, as a source of improvement of economic well-being, for example through financial and technical assistance, leading to rapid economic growth and prosperity. It is also seen, increasingly, as a device for strengthening regional strategic security, especially in the context of what is often perceived as a watering down of the defensive nature of NATO. The social perception of the EU as not essentially a human rights related entity is largely justified. For one thing, the constituent European treaties — a primary source of knowledge about the EU for non-members — contain very few human rights provisions.[76] Similarly, and very importantly to those who identify rights practice with their justiciability, the actual human rights record of the ECJ, quantitatively at least, is quite insignificant.[77] This public perception of the EU explains why the EU Charter has not loomed large in debates about the pros and cons of accession in the Central and Eastern European states. But this need not be so in the future, and the greater the prominence given to the Charter and to the human rights policies of the EU in the post-accession period, the more likely that the sovereignty conundrum will be largely overcome insofar as its effect upon the behaviour of new Member States is concerned.

One opportunity, regrettably, has been lost. I refer to the possibility of involving the candidate states' representatives in the substantive debate on the Charter during the Convention on the Future of the EU. In that debate, the Charter was largely treated as substantively untouchable. [78] The accession states, facing a 'take it or leave it' situation, of course have taken it, mainly because they cannot afford at this crucial stage of accession to open a major front of conflict with the Member States over fundamental normative ideals concerning the future of Europe.[79] Alas, the potential of the

[European] Treaties for the protection of individual rights are impressive': W Czaplinski and N Fernandez Sola, 'Demokratyczna forma rzadów i ochrona praw czlowieka w Unii Europejskiej w swietle Traktatów z Maastricht i Amsterdamu' in Czaplinski, above n 57 at 179.

[76] Textual human rights provisions of the European Treaties as amended by Treaties of Amsterdam and Treaty of Nice are limited to the principled commitments of Art 6 of TEU, to the Art 7 TEU (powers to investigate the internal policies of Member States in order to monitor compliance with human rights), Art 11 TEU (referring to human rights as an objective of CFSP), Art 177 of ECT development policy agreements, Art 13 of ECT on anti-discrimination legislation, Art 181a ECT (on economic, financial and technical cooperation with third countries), Art 136 ECT (social rights) and Art 141 ECT (equal treatment of men and women).

[77] See von Bogdandy, above n 18 at 1321; B de Witte, 'The Past and Future Role of the European Court of Justice in the Protection of Human Rights' in Alston, above n 11, 859–97 at 869.

[78] There is a strong and understandable temptation to treat the Charter as a document which should be included in the future EU Constitution 'as is,' and thus best treated as an optimal charter of rights achievable within the EU at this current point in time; any revisiting of the document would be seen as fraught with the danger of (re)opening Pandora's box; see above, n 6.

[79] For a good description of Poland's official attitude towards the future of the EU, and its reluctance to enter into fundamental controversy about the *finalité*, see R Trzaskowski, 'From

Charter to penetrate the public discourse about the constitutional future of the EU has been largely lost. (I put to one side the missed potential for generating a debate about the Charter in the West. Although it is an interesting and in many respects an impressive document, it is not beyond substantive criticism,[80] and treating it as untouchable at the first democratic quasi-constitutional forum dealing with the 'future of Europe' smacks of manipulative politics.)

The formal endorsement of the Charter by the representatives of the accession countries had to be superficial and perfunctory for the reasons so well described by Antje Wiener. Norm-compliance increases as agents have a possibility to contest norms at the stage of their formulation because it maximises what Wiener calls 'norm resonance', ie the general alignment of the supranational norms with the domestic context. As Wiener notes, 'the more the conditions for access to participation in the process of validating constitutional norms are enhanced, the more likely it is that the constitutional bargain resonates well within the fifteen plus domestic contexts.'[81] Indeed, among the factors sometimes pointed to as having fed 'Eurosceptic' attitudes within the accession states is the fact that 'the EU is becoming more and more "defined", which limits the possible revisions to it';[82] by contrast, the sense of at least potential co-authorship of EU rules should foster a generally positive attitude towards the Union.

CONCLUSIONS: CONSTITUTIONALISATION, RIGHTS AND ENLARGEMENT

At the outset of this chapter, I characterised the parallelism of constitutionalisation and enlargement as both a potential threat and an opportunity. One way in which it is an opportunity is that it may indicate to the leading actors in both processes (the elites in the Member States, in the accession

Candidate to Member State: Poland and the Future of the EU' *The European Union Institute for Security Studies* (Occasional Paper No 37, September 2002).

[80] For a damning, but serious and detailed critique of the substance of the Charter, see N Roos [Professor at Maastricht University], 'Fundamental Rights, European Identity and Law as a Way to Survive' *Working Group on Human Rights* (unpublished paper presented at the conference on Methodology and Epistemology of Comparative Law, Brussels, October 2002). For a gentler suggestion that some provisions of the Charter need further work, before the (proposed) incorporation of the Charter into the Treaties, see J Schwartze, 'Constitutional Perspectives of the European Union with Regard to the Next Intergovernmental Conference in 2004' (2002) 8 *European Public Law* 241 at 248. These critiques of the Charter should be invited rather than avoided at this stage of constitutional discourse.

[81] Wiener above n 3 at 30.

[82] P Kopecký and C Mudde, 'The Two Sides of Euroscepticism: Party Positions on European Integration in East Central Europe' (2002) 3 *European Union Politics* 297 at 319.

states, and in Brussels) that a lot of learning from one process is available to enhance the other. More specifically, the rules worked out in the dynamic process of accession of new members may feed back into the constitutional structure of the EU in ways which would have not been thought of, or which would be politically less practicable, in the absence of enlargement. An example is the way in which the rules on minority protection, coined as they were for the purpose of policing the internal behaviour of candidate states, may penetrate into the constitutional normativity of the EU as a whole. As Bruno de Witte speculates, one can envisage a scenario 'in which accession of Central and Eastern European countries will gradually make minority questions more prominently present in the institutional system and in the policies of the EU.'[83] More generally, the whole set of meanings and interpretations worked out in the context of conditionality, as evidenced well by the remarkably wide-ranging annual report of the Commission on each candidate country's progress towards accession, may well become a part of the Union's institutional memory and loop back in the broader context of the EU, beyond the limited parameters of enlargement.[84] In that way, the parallel pursuit of enlargement and of constitution making produces synergies which can be beneficial for a better understanding and a fine-tuning of constitutional rights within the EU's constitution.

This leads to a broader point regarding the role of values and norms in the construction of the identity of the EU. The normative force of the motives and arguments for enlargement — the force emphasised in the work of such authors as Frank Schimmelfennig,[85] Karin Fierke and Antje Wiener,[86] Lykke Friis and Anna Murphy,[87] and Ulrich Sedelmeier[88] — has enormous potential for infusing the EU constitution making process with value-orientation and with a deliberate reflection on the axiological (as opposed to the merely managerial or economic) reasons for a stronger political union supported and symbolised by the constitutional document.[89]

[83] De Witte, above n 4 at 240.
[84] See, similarly, Wiener above n 3 at 15.
[85] Most recently, 'Liberal Community and Enlargement: An Event History Analysis' (2002) 9 *Journal of European Public Policy* 598. For a good summary of the 'constructivist' approaches to enlargement (which emphasises the importance of shared norms and values), see F Schimmelfennig and U Sedelmeier, 'Theorizing EU Enlargement: Research Focus, Hypotheses, and the State of Research' (2002) 9 *Journal of European Public Policy* 500.
[86] K Fierke and A Wiener, 'Constructing Institutional Interests: EU and NATO Enlargement' (1999) 6 *Journal of European Public Policy* 721; see also Wiener, above n 3.
[87] See eg L Friis and A Murphy, 'The European Union and Central and Eastern Europe: Governance and Boundaries' (1999) 37 *Journal of Common Market Studies* 211.
[88] 'Eastern Enlargement: Risk, Rationality, and Role-Compliance' in M Green Cowles and M Smith (eds), *Risk, Reforms, Resistance, and Revival: The State of the European Union*, vol 5 (Oxford, Oxford University Press, 2000) 164–85.
[89] As an interesting variation on Schimmelfennig's theme, Helene Sjursen argues that, within the set of normative values, it was the sense of 'ethical-political arguments … revealed through

Often, the 'values talk' in EU constitutional discourse has been either marginalised (as the domain of idealists, fanatics or ignorants for whom lofty talk about 'values' is last refuge) or turned into ritualistic platitudes. For one following the proceedings of the Convention, Joseph Weiler's complaint of not so long ago that '[t]he Europe of Maastricht suffers from a crisis of ideals,' and that it contrasts with the Community's formative years when 'the very idea of the Community was associated with a set of values which … could captivate the imagination…,'[90] still largely rings true. As Schimmelfennig's penetrating articles show, norms and ideals have had an enormous explanatory and pragmatic power in the enlargement process. Indeed, we are unable to understand the strategic move of the Union toward enlargement (with all its headaches, risks, troubles, and costs, and with rather uncertain and contingent benefits), unless we conceive of it as a process in which the norms, once solemnly spelled out in political and constitutional (or quasi-constitutional) documents, acquire a life of their own and bind their authors, or their authors' successors. Enlargement of the EU, or indeed of any international organisation or polity, is a result not only (and, sometimes, not at all) of a cool calculus of costs and benefits. Such a development may occur not only where the marginal benefits for the incumbent and for the applicant states alike outweigh the marginal costs, but also where there is a strong resonance between the dominant norms which underlie the international organisation or polity and the applicant states. The one will tend to gravitate towards the other, with the process of mutual attraction culminating, finally, in accession. [91]

This insight may be fruitfully used in the constitutional process. It is going to be necessary to infuse constitutional discourse with a more open and direct reflection over the fundamental values of the Union[92] and about

references to values and traditions . . . seen as constitutive of European identity' which has been operative in triggering the enlargement process: see H Sjursen, 'Why Expand? The Question of Legitimacy and Justification in the EU's Enlargement Policy' (2002) 40 *Journal of Common Market Studies* 491 at 502. Sjursen contrasts these 'ethical-political' reasons not only to 'pragmatic' ones but also, interestingly, to 'moral' reasons such as norms of justice, rights and democracy. Sjursen believes that the marked difference in the attitude of the EU towards CEE on the one hand, and towards Turkey on the other hand, proves that it was an appeal to an identity based on a community of values which was decisive. I am not sure how significant this distinction is, and whether it goes beyond mere rhetoric. But from the point of view of my argument it does not matter; what does matter is that the dominant argument behind enlargement refers to those very values which are recognised as the values underlying political union in the Western part of Europe.

[90] Weiler, above n 74 at 238–39. These words come from a paper initially published in 1995.
[91] See (not in these words) F Schimmelfennig and U Sedelmeier, 'Theorizing EU Enlargement: Research Focus, Hypotheses, and the State of Research' (2002) 9 *Journal of European Public Policy* 500 at 513–15.
[92] Joseph Weiler speaks of '(re)introduce[ing] a discourse on ideals into the current debate on European integration.' Weiler, above n 74 at 239.

fidelity to the norms spelled out in the foundational documents of the Union if the constitution making process is to have a real purchase upon the public imagination and perform a positive role in polity building.[93] It is hard to build a polity around debates on qualified majority voting or on the composition of the Council. But it is also boring to repeat the mantra of 'common values.' A more open attempt to spell out values and to forge a link between the values and the institutional design is a challenge, and a promise, which may enrich the constitution making process and make it more sensitive to community expectations. Even more fundamentally, and apart from the 'community-mobilising'[94] capacity of such a direct appeal to values, there is a clear parallel between the rationale for enlargement (in Schimmelfennig's terms) and the ways of enhancing the constitutional debate. As Neil Walker has observed: 'the very constitutional ideals that have facilitated the Enlargement process are also those which are crucial to the present policy building phase of the EU in nurturing the sense of a common identity and of a community of attachment on which the legitimacy of the polity rests.'[95]

To put the point differently, the normative ideals of the EU which emanate from its 'promise,' which are built into its foundational documents, and which have impelled enlargement, constitute a normative template which should inform a constitutional reflection on the future of the EU. The enlargement with its powerful normative texture (captured by the rhetoric of a 'return to Europe')[96] may serve as a reminder that the EU's identity is crucially founded upon certain values, of which respect for human rights is among the most important. To the extent that enlargement has been normatively, rather than pragmatically, driven, this normativity creates an important resource for the construction of the constitution of Europe.

Further, the parallelism between constitutionalisation and enlargement offers a context in which both processes may be seen as demanding an infusion of democratic, bottom-up procedural rules and principles. A frequent complaint about the way the enlargement process was initiated and ran was that it was basically a technocratic, elite-based exercise;[97] the results of the

[93] On the role of the constitution in polity building, in the context of EU constitutionalism, see N Walker, 'Constitutionalizing Enlargement, Enlarging Constitutionalism' (2003) 9 *European Law Journal* 365.
[94] *Ibid* at 379–383.
[95] *Ibid* at 379. For a similar point, see D Piana, 'Il processo di allargamento come politica costituente: cambiamento di paradigma e effetti non intenzionali nella costruzione dell'Europa allargata' (unpublished manuscript on file with the author, 2002) at 23.
[96] See K M Fierke and A Wiener, 'Constructing Institutional Interests: EU and NATO Enlargement' (1999) 6 *Journal of European Public Policy* 721.
[97] See JHH Weiler, 'Fischer: the Dark Side' in C Joerges, Y Mény and JHH Weiler (eds), *What Kind of Constitution for What Kind of Polity? Responses to Joschka Fischer* (Florence, Robert

first Irish referendum may be partial evidence of the consequences of not taking seriously enough the democratic demands of society to have its say in the future of Europe.[98] The Convention on the Future of Europe provided space, albeit a limited one, for reducing this democratic deficit of enlargement. For one thing, it offered a chance for participants to bring enlargement-related issues onto the general agenda of deliberations on the future of the Union, thus infusing the enlargement process itself with a measure of democratic legitimacy. For another thing, the Convention brought the representatives of the candidate countries onto a common debating platform with the representatives of the Member States, thereby reducing the distance between the 'rule setters' and the 'rule followers'. Even though their voice in the Convention was not exactly equal to that of the Member States,[99] it was far stronger, in terms of status and in terms of quality of representation, than the pale and miserable 'auditions' arranged within the process of drafting the EU Charter only two years earlier.[100] In turn, the pressure from the candidate states — clearly sensitive, as newcomers, about being allowed to be heard[101] — made the entire Convention forum and the post-Convention constitutional deliberations more amenable to democratic and participatory rules.

Neil Walker recently articulated the intriguing idea that the constitutional dimension of the EU has contributed to reducing the asymmetry of power between the current Member States and the candidates.[102] One ground upon which he bases this conclusion is that the first involvement of the *candidate states* in constitutional processes within the Convention was at the same time the first involvement in such a process of so broad a range of representative institutions of *Member States*. It created therefore 'a more level discursive playing-field,'[103] serving to lessen the imbalance of powers inherent in the relationship between the club master and the applicant.

Schuman Centre for Advanced Studies, European University Institute, 2000) 235–47 at 236–37; see also JHH Weiler, 'A Constitution for Europe? Some Hard Choices' (2002) 40 *Journal of Common Market Studies* 563 at 564.

[98] 'Partial' — because arguably the failure of the first Irish referendum to support the Nice Treaty was largely due to factors which had nothing to do with the 'No-vote' campaigners' views about the future composition of the EU.

[99] The rules for participation of the 'candidate states' representatives basically provide that they have the same rights as all the other representatives with one exception: they will not 'be able to prevent any consensus which may emerge among the Member States,' European Council Meeting in Laeken, 14–15 December 2001, Annex I to Presidency Conclusions: Laeken Declaration on the Future of the European Union, section III.

[100] See Sadurski, above n 10 at 346–48.

[101] For a good description of this sensitivity, see KY Konstantinov, 'The Convention and the Accession States: Where Do We Stand? Where Do We Sit?' *Challenge Europe* (January 2002) <http://www.theepc.be/challenge/> (15 March 2003).

[102] Walker, above n 93.

[103] *Ibid* at 383.

Walker's conclusions resonate with mine. Constitutionalisation of rights can act as an equaliser between the 'enlargers' and the 'enlargees'. This is because, as I argued in part two, the emphasis on rights can largely help overcome the sovereignty conundrum which has the potential of adversely affecting the smoothness of the absorption of new Member States into a deepened political union, and creating a division of the new Union into the core (relaxed about the sovereignty issues) and the periphery (obsessed about its sovereignty). But constitutional rights do not lend themselves to 'reinforced cooperation' models, with a core and a periphery. Either you are in or you are out. Hence, a constitutionalised rights system within the EU will counteract moves towards the division of members into the first and second categories. As Giorgio Sacerdoti observes: 'The eurozone and the Schengen countries do not effectively embrace the whole Union … [but] fundamental rights are part of the global framework, shared and indispensable features of the whole Union.'[104]

If rights become constitutionalised within the EU, and the EU Charter becomes a full-fledged constitutional document, a powerful stimulus will have been created for a deepening and enlarging of the Union and at the same time provide a (partial at least) answer to those who see the territorial 'widening' as standing in inverse relationship to institutional 'deepening' of the EU. This is not to say that constitutionalisation of rights within the EU is an unqualifiedly good thing, and that no serious objections can be set mounted against an idea of a robust and judicially enforceable Charter of Rights in the EU.[105] But from the perspective of enlargement and the post-accession absorption of the new states into the Union — the only perspective of concern for this chapter — constitutionalised rights at the EU level may help establish a common constitutional space in which the Member States' constitutional charters of rights are part and parcel of an overall constitutional structure. It goes without saying that those constitutional rights will not be self-executing, and their impact upon the absorption of the new Member States into the EU polity will depend, to a large degree, upon the role of the ECJ as a putative future constitutional court of the EU, exercising its review under — among other things — fundamental rights. The ECJ so far has been a major force in EC/EU polity building, and the extension of its powers to rights scrutiny — even if deeply problematic from many points of view[106] — may have a positive effect upon the integration of the new Member States of the EU into a common constitutional space.

[104] G Sacerdoti, 'The European Charter of Fundamental Rights: From a Nation-State Europe to a Citizens' Europe' (2002) 8 *Columbia Journal of European Law* 37 at 51.
[105] The most sustained and serious objections have been formulated by JHH Weiler; for the most recent expression of these objections see Weiler, above n 97 at 574, and earlier, JHH Weiler, 'Editorial, Does the European Union Truly Need a Charter of Rights?' (2000) 6 *European Law Journal* 95.
[106] For an argument against such a vision for the ECJ, see von Bogdandy, above n 18 at 1320–30.

References

Agh, A (2002) 'Ten Years of Political and Social Reforms in Central Europe' 2 *Central European Political Science Review* 24.

Albi, A (2003) 'Postmodern Versus Retrospective Sovereignty: Two Different Discourses in the EU and the Candidate States?' in N Walker (ed), *Sovereignty in Transition* (Oxford, Hart Publishing).

Alston, P and Weiler, JHH (1999) 'An "Ever Closer Union" in Need of a Human Rights Policy: The European Union and Human Rights' in P Alston (ed), *The EU and Human Rights* (Oxford, Oxford University Press).

Barcz, J (1988) 'Akt integracyjny Polski z Unia Europejska w swietle Konstytucji RP' 4 *Panstwo i Prawo* 3.

—— (1999) 'Suwerennosc w procesach integracyjnych' in W Czaplinski (ed), *Suwerennosc i integracja europejska* (Warsaw, Warsaw University Centre for Europe).

Bermann, G (2001) 'Law in an Enlarged European Union' 14 *European Union Studies Association Review* (Summer).

Breuilly, J (1982) *Nationalism and the State* (New York, St Martin's Press).

Cartabia, M (2001) 'Allargamento e diritti fondamentali nell'Unione Europea. Dimensione politica e dimensione individuale' in S Guerrieri, A Manzella and F Sdogati (eds), *Dall'Europa a Quindici alla Grande Europa. La Sfida Istituzionale* (Bologna, Il Mulino).

Cowles, MG and Smit, M, (2000) *Risk, Reforms, Resistance, and Revival: The State of the European Union*, vol 5 (Oxford, Oxford University Press).

Czaplinski W and Fernandez Sola, N (1999) 'Demokratyczna forma rzadów i ochrona praw czlowieka w Unii Europejskiej w swietle Traktatów z Maastricht i Amsterdamu' in W Czaplinski (ed), *Suwerennosc i integracja europejska* (Warsaw, Warsaw University Centre for Europe).

de Búrca, G (2001) 'Human Rights: The Charter and Beyond' (Jean Monnet Working Paper No. 10/01).

—— (2002) 'Convergence and Divergence in European Public Law: The Case of Human Rights' in P Beaumont in C Lyons and N Walker (eds), *Convergence and Divergence in European Public Law* (Oxford, Hart Publishing).

de Witte, B (1998) 'Sovereignty and European Integration: the Weight of Legal Tradition' in AM Slaughter, A Stone Sweet and JHH Weiler (eds), *The European Court and National Courts — Doctrine and Jurisprudence* (Oxford, Hart Publishing).

—— (2001) 'Constitutional Aspects of European Union Membership in the Original Six Member States: Model Solutions for the Applicant Countries?' in AE Kellerman, JW de Zwaan and J Czuczai (eds), *EU*

Enlargement: The Constitutional Impacts at EU and National Level (The Hague, TMC Asser Press).

—— (2003) 'The Impact of Enlargement on the Constitution of the European Union' in M Cremona (ed), *The Enlargement of the European Union* (Oxford, Oxford University Press).

de Witte, B and Toggenburg, G (2003) 'Human Rights and Membership of the Union' in S Peers and A Ward (eds), *The EU Charter of Fundamental Rights* (Oxford, Hart).

Fierke, KM and Wiener, A (1999) 'Constructing Institutional Interests: EU and NATO Enlargement' 6 *Journal of European Public Policy* 721.

Friis, L and Murphy, A (1999) 'The European Union and Central and Eastern Europe: Governance and Boundaries' 37 *Journal of Common Market Studies* 211.

Grabbe, H (2003) 'Will EU Membership Improve Governance and the Quality of Democracy in Central and Eastern Europe?' (unpublished manuscript, copy on file with author).

—— (2002) 'European Union Conditionality and the *Acquis Communautaire*' 23 *International Political Science Review* 249.

Habermas, J (2001–02) 'So, Why Does Europe Need a Constitution?' *Robert Schuman Centre* (Policy Papers, Series on Constitutional Reform of the EU).

Harmsen, R (2001) 'The European Convention on Human Rights after Enlargement' 5 *International Journal of Human Rights* 18.

Kay, RS (2000) 'The European Human Rights System as a System of Law' 6 *Columbia Journal of European Law* 55.

King, T (1996) 'The European Community and Human Rights in Eastern Europe' 23 *Legal Issues of European Integration* 93.

Kis, J (1992) 'Nation-Building and Beyond' in W Kymlicka and M Opalski (eds), *Can Liberal Pluralism be Exported? Western Political Theory and Ethnic Relations in Eastern Europe* (Oxford, Oxford University Press).

Kopecký, P and Mudde, C (2002) 'The Two Sides of Euroscepticism: Party Positions on European Integration in East Central Europe' 3 *European Union Politics* 297.

Lenaerts, K (2001) 'The Impact of the EU Charter of Fundamental Rights in the Perspective of Enlargement' in AE Kellerman, JW de Zwaan and J Czuczai (eds), *EU Enlargement: The Constitutional Impacts at EU and National Level* (The Hague, TMC Asser Press).

Menéndez, AJ (2002) 'A Rights-Based Europe?' in EO Eriksen, JE Fossum and AJ Menéndez (eds), *Constitution-Making and Democratic Legitimacy* (Oslo, Arena).

Nikodém, A (2001) 'Constitutional Impact of the Eastward Enlargment in Central-Eastern Europe. Report on Session III' in AE Kellerman, JW de Zwaan and J Czuczai (eds), *EU Enlargement: The Constitutional Impacts at EU and National Level* (The Hague, TMC Asser Press).

Novak, M (1999) 'Human Rights "Conditionality" in Relation to Entry to, and Full Participation in, the EU' in P Alston (ed), *The EU and Human Rights* (Oxford, Oxford University Press).

Offe, C (1993) 'Ethnic Politics in European Transitions,' *Universität Bremen* (Working paper of Zentrum for Europäische Rechtspolitik an der Universität Bremen, February 1993).

Pridham, G (2002) 'The European Union's Democratic Conditionality and Domestic Politics in Slovakia: the Meciar and Dzurinda Governments Compared' 54 *Europe-Asia Studies* 203.

Raczynska, A (2001) 'Reinterpretacja pojecia suwerennosci wobec czllonkostwa w Unii Europejskiej' 1 *Przeglad Europejski* 95.

Sacerdoti, G (2002) 'The European Charter of Fundamental Rights: From a Nation-State Europe to a Citizens' Europe' 8 *Columbia Journal of European Law* 37.

Sadurski, W (2002) 'Charter and Enlargement' 8 *European Law Journal* 340.

Sajo, A (1993) 'Protecting Nation States and National Minorities: A Modest Case for Nationalism in Eastern Europe' *University of Chicago Law School Roundtable*.

Schimmelfennig, F and Sedelmeier, U (2002) 'Theorizing EU Enlargement: Research Focus, Hypotheses, and the State of Research' 9 *Journal of European Public Policy* 500.

Schokkenbroek, J and Ziemele, I (2000) 'The European Convention on Human Rights and the Central and Eastern European Member States: an Overview' *Nederlands Juristenblad* 1914.

Schöpflin, G (2001) 'Liberal Pluralism and Post-Communism' in W Kymlicka and M Opalski, *Can Liberal Pluralism be Exported? Western Political Theory and Ethnic Relations in Eastern Europe* (Oxford, Oxford University Press).

Shapiro, M and Stone, A (1994) 'The New Constitutional Politics of Europe' 26 *Comparative Political Studies* 397.

Sjursen, H (2002) 'Why Expand? The Question of Legitimacy and Justification in the EU's Enlargement Policy' 40 *Journal of Common Market Studies* 491.

Smith, KE (2001) 'Western Actors and the Promotion of Democracy' in J Zielonka and A Pravda (eds), *Democratic Consolidation in Eastern Europe*, vol 2 (Oxford, Oxford University Press).

von Bogdandy, A (2000) 'The European Union as a Human Rights Organization? Human Rights and the Core of the European Union' 37 *Common Market Law Review* 1307.

Walker, N (2001) 'Human Rights in a Postnational Order: Reconciling Political and Constitutional Pluralism' in T Campbell, KD Ewing and A Tomkins (eds), *Sceptical Essays on Human Rights* (Oxford, Oxford University Press).

—— (2002) 'The Charter of Fundamental Rights of the European Union: Legal, Symbolic and Constitutional Implications' in PA Zervakis and PJ Cullen (eds), *The Post Nice Process: Towards a European Constitution* (Nomos, Baden-Baden).

—— (2003) 'Constitutionalizing Enlargement, Enlarging Constitutionalism' 9 *European Law Journal* 365.

Weiler, JHH, (1999) *The Constitution of Europe* (Cambridge, Cambridge University Press).

—— (2000) 'Fischer: the Dark Side' in C Joerges, Y Mény and JHH Weiler (eds), *What Kind of Constitution for What Kind of Polity? Responses to Joschka Fischer* (Florence, European University Institute).

—— (2000) 'Editorial, Does the European Union Truly Need a Charter of Rights?' 6 *European Law Journal* 95.

—— (2002) 'A Constitution for Europe? Some Hard Choices' 40 *Journal of Common Market Studies* 563.

Whitefield S and Evans, G (2001) 'Attitudes towards the East, Democracy, and the Market' in J Zielonka and A Pravda (eds), *Democratic Consolidation in Eastern Europe*, vol 2 (Oxford, Oxford University Press).

Wiener, A (2002) 'Finality vs Enlargement: Constitutive Practices and Opposing Rationales in the Reconstruction of Europe' (Jean Monnet Working Paper 8/02).

Williams, A (2000) 'Enlargement of the Union and Human Rights Conditionality: A Policy of Distinction?' 25 *European Law Review* 601.

Wójtowicz, K (2001) 'Suwerennosc w procesie integracji europejskiej' in WJ Wolpiuk (ed), *Spór o suwerennosc* (Warsaw, Wydawnictwo Sejmowe).

Wyrzykowski, M (1999) 'Klauzula europejska — zagrozenie suwerennosci? (suwerennosc a procedura ratyfikacyjna czlonkostwa Polski w UE)' in W Czaplinski (ed), *Suwerennosc i integracja europejska* (Warsaw, Warsaw University Centre for Europe).

4

The Challenge of Cooperative Regulatory Relations after Enlargement

FRANCESCA BIGNAMI

INTRODUCTION

WITHOUT TRUST, MARKETS and governments fail.[1] In southern Italy, in order to buy a cow for slaughter, a butcher must go to both the local cattle farmer and the local Mafioso, the cattle farmer for the cow, the Mafioso to make sure the head of cattle is healthy.[2] The Mafioso sells a substitute for trust, an expensive and ultimately destructive substitute, one that has in fact been the leading cause of the South's economic backwardness, but one that is necessary if the transaction is to occur. In southern Italy, regional bureaucrats are unresponsive to citizen requests and fail to build day care centres, family clinics, and public housing even though they have the tax dollars to do so.[3] Why? Because officials and their citizens are not part of networks of civic engagement which breed social trust and therefore are unable to cooperate in addressing the complex socio-economic problems faced by regional governments.

In analytical sociology, trust is a belief which explains cooperation in a variety of relationships, social and economic, where individual incentives, without more, would predict selfish behaviour. In collective action games of different varieties, the two players can either choose to cooperate or defect.[4]

[1] I would like to thank George Bermann, Gráinne de Búrca, Peter Doralt, Diego Gambetta, Henry Hansmann, Robert Keohane, Xavier Lewis, Milada Vachudova, Joseph Weiler, Stephen Williams, David Zaring, and participants in the Columbia conference for their comments.

[2] See D Gambetta, *The Sicilian Mafia: The Business of Private Protection* (Cambridge, Harvard University Press, 1993).

[3] See RD Putnam, *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton, Princeton University Press, 1993).

[4] I use the term collective action game to refer to all games in which the parties are better off if they both cooperate and worse off if they both defect. For my purposes, it is not important to distinguish among prisoner's dilemma, chicken, stag hunt, tragedy of the commons, and other games which fit into this category. In these games, there are two players, each of whom can

Because of the risk of opportunistic behaviour by the other, both players will choose to defect rather than cooperate and therefore will not obtain the mutually beneficial outcome. Institutions which alter the structure of the game or which facilitate the monitoring and sanctioning of opportunistic behaviour can improve the chances of cooperation. Norms and beliefs, although much more difficult to operationalise and empirically verify, can complement institutions in inducing individuals to cooperate. A player who trusts another player, ie believes that the other will cooperate rather than behave opportunistically, is more willing to take a risk and cooperate herself.

In European governance, the critical relationships are not market transactions among firms or citizens' efforts to build day care centres, but rather a continuing series of bargains among government officials.[5] In large measure, these relations rest upon formal institutions which create incentives for cooperative behaviour. The committee system, notification requirements, the Commission, and the Court of Justice all guarantee the prospect of repeated interactions, reliable information on cooperation or defection, and sanctions for regulators who fail to deliver on promises. For the European common market to operate as an administrative reality, however, reciprocity and trust are equally important. The assertion that individuals can develop norms and beliefs outside of the thick cultural web of a local or national community is a contentious one. Nonetheless, in observing the dense and sustained nature of interactions among European regulators, I conclude that the common market is coming to rely upon trust as much as upon institutional incentives. A regulator from one country (X) believes that a regulator from another country (Y) will cooperate, even though Y is part of a different political and administrative system, because Y has demonstrated through past behaviour that she will cooperate, because she is part of another regulatory network which would disapprove if she were to defect, and because she shows signs of trustworthiness developed in other multinational forums.

Enlargement represents a radical challenge to the system of cooperative regulatory relations and trust at the heart of the common market.[6] For a

either cooperate (C) or defect (D) and neither of whom knows which strategy the other player will adopt. They are similar in that, for each player, the (C,C) outcome is preferable to the (D,D) outcome. The specific pay off structures, however, differ. For instance, in prisoner's dilemma, chicken, and tragedy of the commons, the individual player will prefer the (D,C) to the (C,C) outcome while in stag hunt, the individual player will prefer (C,C) to (D,C). See K Oye, 'Explaining Cooperation under Anarchy: Hypotheses and Strategies' in K Oye (ed), *Cooperation under Anarchy* (Princeton, Princeton University Press, 1986).

[5] For the theory that state interests and intergovernmental bargaining lie behind European integration, see A Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (Ithaca, Cornell University Press, 1989).

[6] For the importance of trust in building democratic institutions within Eastern European countries, see S Rose-Ackerman, 'Trust and Honesty in Post-Socialist Societies' (2001) 54 *Kyklos* 415 and S Rose-Ackerman, 'Trust, Honesty and Corruption: Reflections on the State-Building Process' (2001) 42 *Archives of European Sociology* 526.

number of reasons, regulators in existing Member States doubt that Central and Eastern European regulators have the capacity to administer the *acquis communautaire*.[7] The number of countries, together with the density of European norms, exceeds any previous accession. Ten new sets of regulators, from 10 different political traditions, not two or three, will be asked to join European administrative networks. Unlike their Greek and Iberian predecessors, these countries join at a time of high normative density. The vast majority of harmonisation measures were passed after the Single European Act, each one requiring regulatory cooperation at every twist and turn, from interpretation to enforcement to reassessment and reformulation of the normative framework. Since the fall of Communism, the states of Central and Eastern Europe have had to rebuild their markets and state institutions, and their experience with their administrative systems is still relatively limited.

Developing cooperation and trust among regulators of existing and new Member States will be especially difficult due to the shift in power relations that will occur after enlargement. Throughout the enlargement process, the Commission and Member State administrations have been able to rely on power to obtain compliance from Central and Eastern European countries.[8] Existing Member States benefit from access to the new markets, but the accession states benefit significantly more through the combination of access to western markets and subsidies. However, once May 2004 comes and goes, the power differential will gradually narrow and mutually beneficial cooperation among equals, rather than power, will be necessary for successful administration. This shift will not necessarily be easy, for hierarchical political and social relations are not conducive to developing norms of reciprocity or trust.[9] One party is at risk of exploiting her power and the other party protects herself, through guile or other devices. In the immediate aftermath of enlargement, as thousands of old and new regulators begin administering the common market as equals, without reciprocity and trust, they may very well choose defection over cooperation, thus, through the downward spiral predicted by game theorists, compromising regulatory cooperation and the reality of a common market for years to come. An old regulator might continue to believe, erroneously, that she can deprive new regulators of certain benefits in a discrete policy area and still obtain cooperation on account of the disproportionate advantages of membership.

[7] *Acquis communataire* or *acquis* refers to the body of EU norms — treaties, secondary instruments, implementing rules, and court decisions — which Eastern European countries have adopted to qualify for enlargement.

[8] See MA Vachudova, 'The Leverage of Internationalizing Institutions on Democratizing States: Eastern Europe and the European Union' *Robert Schuman Centre for Advanced Studies* (RSCAS Working Paper No 2001/33 European University Institute Fiesole, 2001); A Moravcsik and MA Vachudova, 'National Interests, State Power, and EU Enlargement' (2003) 17 *East European Politics and Societies* 42.

[9] See generally D Putnam, *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton, Princeton University Press, 1993).

A new regulator may be readier to perceive defection rather than cooperation due to her experiences during the enlargement process, and defect herself. If this occurs, a common market in the Europe of 25 will not emerge anytime soon.

This chapter is divided into three parts. In the first part, I conceptualise European administration as a continuous series of collective action games among government officials in which cooperation is critical. The operative metaphor is a contractual relationship among independent firms rather than a single, vertically integrated, hierarchical firm. A regulator from one country transfers her authority to a regulator from another country, thus allowing goods and services to circulate domestically even though they do not comply with her rules and procedures, in return for a transfer of regulatory authority in kind. The contract establishing the terms of the transfer — the Treaty, the secondary instruments, and the implementing rules — is incomplete and there is a significant risk of opportunism. Regulators belong to different administrative hierarchies and political cultures and therefore face pressures to behave strategically when they implement the contract or renegotiate its incomplete terms. Nevertheless, national regulators cooperate rather than defect due to the prospect of repeat plays, monitoring and sanctioning, and trust. European administration is understood as a set of mutually beneficial relations among independent regulators, and not as a hierarchy with supranational institutions and courts at the top and national administrators below.

In the second part, I situate my approach in mainstream theories of European integration. I draw significantly on the institutionalist tradition in international relations scholarship, in which international regimes, including the European Union, are explained as solutions to collective action problems among sovereign nations.[10] Still, the unprecedented level of cooperation among Member States has been accompanied by novel practices and institutions to facilitate that cooperation. I explain how these new forms of cooperation challenge some of the premises of classic institutionalist theory and consider the alternative explanation of European integration put forward by neo-functionalists.[11] Although my approach shares important similarities with that theory, it differs in that I perceive integration as proceeding through national politics and cooperation among 25 different administrative and political systems, rather than through the construction of a single system.

[10] R Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton, Princeton University Press, 1984); A Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (Ithaca, Cornell University Press, 1989).
[11] W Sandholtz and A Stone Sweet, 'Integration, Supranational Governance, and the Institutionalization of the European Polity' in W Sandholtz and A Stone Sweet (eds), *European Integration and Supranational Governance* (Oxford, Oxford University Press, 1998).

In the third part, I use the collective action understanding of European governance to analyse the difficulties that enlargement will create for the common market and to suggest possible correctives. As already mentioned, cooperative regulatory relations will be difficult to establish because of lack of confidence in the administrative capacity of Central and Eastern European countries and because of their experience with power relations in the years preceding enlargement. The solution, I argue, is awareness of the structure of the game in both the existing and the new Member States, a more active role for the Commission and the Court in monitoring compliance in the Member States, and strict adherence to a strategy of reciprocity in retaliating for non-compliance. Moreover, I anticipate that greater centralisation will occur in select areas such as food safety and monetary policy, areas in which the risk of defection imposes such high costs on national regulators that they are willing to relinquish their own enforcement authority in return for greater control over enforcement elsewhere.

THE COLLECTIVE ACTION CONCEPTION OF EUROPEAN GOVERNANCE

The Analogy

The key to understanding European governance is an appreciation that things get done — goods move across borders and into shops, smokestacks get fitted with scrubbers, farmers get rewarded with subsidies for ploughing under their vineyards — under conditions of anarchy, not hierarchy. The anarchy I have in mind is not the Hobbesian one of nations in the international realm, but the gentler one of firms contracting in a market or union members organising in a collective bargaining regime or villagers operating through local associations to prevent erosion and depletion of their land.[12] In other words, unlike nations in the international arena, we have here a background legal regime. However, this regime does not determine the contract, the decision to strike, the effort to preserve the land, or the extent of trade among European countries. Goods move from supplier to buyer,

[12] O Williamson, *The Economic Institutions of Capitalism* (New York, The Free Press, 1985); M Olson, *The Logic of Collective Action* (New York, Schocken Books, 1971); E Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action* (Cambridge, Cambridge University Press, 1990) 61-69. The term 'anarchy' is drawn from the international relations literature. Even though the process of integration sets the European Union apart from classic international regimes, I use the term to emphasise the continued absence of a sovereign, and hence the enduring relevance of certain tools of international relations theory. As explained below, the game theory used in this chapter was extensively developed in the international relations field to explain cooperation among nations in the absence of a Leviathan. Because the European Union continues to lack many of the fundamental attributes of the state, these concepts still have intellectual purchase in explaining the design and operation of European institutions.

workers go on strike, villagers limit their use of land, and goods and services move across borders because institutions, norms, and beliefs curb opportunism and promote cooperation in strategic game situations.

My collective action analysis of European governance is rough. In Duncan Snidal's words, it is at this stage a metaphor or analogy, rather than a model or theory.[13] Through metaphors and analogies we discern resemblances between entities and suggest ways in which the logic which drives or explains one might also drive or explain the other. The mode of reasoning is primarily inductive, in that the researcher observes certain similarities and speculates as to their significance. Models and theories are far more confident statements about the presence of certain properties in an entity and the causal relationships among those properties. In models or theories, the salient characteristics of a class of phenomena or occurrences are formally identified and their interrelationships and causal effects carefully specified. In particular, a theory is associated with deductive reasoning in that the abstraction of the relevant properties and the specification of the causal arrows permit further implications to be drawn and predictions to be made.

In drawing comparisons between European governance and collective action games, let me provisionally use the analogy of a transaction between two firms for the transfer of an asset such as a machine tool.[14] An official in a national Ministry of Agriculture is like a firm. She trades in the legitimate monopoly of force.[15] She transfers her regulatory authority to another country, thus allowing goods and services to circulate domestically even though they do not comply with her rules and procedures, in return for a transfer of regulatory authority in kind. She negotiates the terms under which she will transfer her authority to another regulator, say the health standards for beef, much as a supplier firm negotiates the price, quantity, and specifications of the machine tool with a buyer firm. The resulting written instrument, be it a new treaty provision, directive, or regulation, is incomplete because the regulators cannot agree on more precise terms

[13] D Snidal, 'The Game Theory of International Politics' in K Oye (ed), *Cooperation under Anarchy* (Princeton, Princeton University Press, 1986).

[14] Contractual relations are generally conceived as one variant of the prisoner's dilemma game. I draw heavily from Oliver Williamson's analysis of the governance structures associated with different types of commercial transactions. See O Williamson, *The Economic Institutions of Capitalism* (New York, The Free Press, 1985). For purposes of the analogy, it is important that the asset be mixed or idiosyncratic because, under those circumstances, the problems of bounded rationality, namely the difficulty of negotiating a complete contract and opportunism are at their worst. If the asset is standard and can easily be obtained on a spot market, then the buyer can purchase the goods without having to negotiate a production contract in advance and both the buyer and seller can trade with any number of other buyers and sellers, reducing considerably the opportunism risks.

[15] I follow Max Weber in defining the state as a political organisation with the legitimate monopoly of the organised use of force within a given territory. The ability to set rules, expect routine obedience of rules, and impose sanctions for occasional disobedience, all turn on this essential attribute of the state. Any transfer of rule making, inspection, and prosecution powers implicates the state's legitimate monopoly of force.

and because they cannot foresee all future developments. Similarly, the production contract is incomplete because of the transaction costs of drafting and negotiating a comprehensive contract and the difficulty of foreseeing every possible contingency. Should there be disagreement over interpretation or performance once the instrument is signed, both parties have an interest in continuing the relationship by negotiating more specific terms and amicably settling disputes. In European administration, goods and services cannot freely circulate without the consent of national regulators. In the market, since the machine tool is made to certain specifications, the buyer cannot easily obtain it from another seller, nor can the seller easily sell it to another buyer.

With a treaty provision or a directive, as with a contract, there is a risk of opportunism by the parties. In European governance, regulators will not reliably disclose their true conditions (information asymmetry) or self-fulfil all promises.[16] In other words, national officials, like contracting firms, cannot and do not operate on the premise that all behaviour is rule-bound.[17] Since they are part of separate governments, administrative hierarchies, and political cultures, regulators face real incentives to defect once they leave Brussels. The demands of pleasing an elected official or advancing in the national bureaucracy can trump good European citizenship. However, if one party alleges that the other did not disclose all relevant information, cheated on a promise, or failed to renegotiate an incomplete term in good faith, there is no clearly recognised legitimate authority to which the dispute can be sent. There is no hierarchy.

Regulators, like firms, may go to court to settle the dispute. In ratifying the Treaty, countries submit to the mandatory jurisdiction of the Court of Justice, thus enabling one Member State to take another to court.[18] Yet both in European governance and in the market, going to court has significant costs: litigation is expensive; courts are poorly situated to settle disputes because their information is limited, they apply general rules that may be ill-suited to the particulars of the transaction, and their involvement can have the effect of putting an end to a mutually beneficial exchange. Regulators and firms therefore rely on informal mechanisms to protect against opportunism, they devise credible commitments and credible threats which supplement litigation, and they set up governance structures which can handle disputes more effectively than courts. Because of the continuous nature of the relationship, one party can punish another party for breaking

[16] O Williamson, 'The New Institutional Economics: Taking Stock, Looking Ahead' (2000) *38 Journal of Economic Literature* 595.
[17] O Williamson, *The Economic Institutions of Capitalism* (New York, The Free Press, 1985) 48. Most of the issues discussed in this section — incomplete contracts, enforcement, and renegotiation — are the bread and butter of contract law. For a comprehensive discussion, see S Shavell, *Foundations of the Economic Analysis of Law* (Cambridge, Harvard University Press, 2004).
[18] ECT, Art 227.

a promise or failing to renegotiate in good faith by denying that party a benefit in their next exchange. The Treaty and European secondary instruments contain a number of credible commitments and credible threats. Independent third parties — the Commission, individual plaintiffs, and courts — are authorised to monitor compliance with the terms of the bargain and apply sanctions,[19] and national regulators may temporarily stop trade with defecting Member States.[20] In the market, firms make investments in assets which depend on the completion of the contract — basically a hostage — thereby demonstrating a commitment to the continuation of the relationship. Finally, in European integration, committees of national regulators, generally known as comitology committees, negotiate more precise standards and mediate disputes on the correct application of European norms under the shadow of a qualified majority vote.[21] Likewise, contracts often stipulate that disputes will be sent to expeditious arbitration bodies or knowledgeable industry experts for resolution.

Sometimes institutions are not necessary to sustain relationships among national regulators or firms.[22] A belief called 'trust' intervenes. Analytical sociology defines trust as a belief held by one individual (X) that another individual (Y) will do something even though Y might have selfish reasons for not doing it and X will lose if Y acts otherwise.[23] One party cooperates because she trusts that the other party to the transaction will also cooperate. The line between rational calculation and belief as bases for cooperation is blurry. Institutions which create incentives for cooperation — monitoring, sanctions, credible commitments, and governance structures — can shape parties' expectations, but belief in trustworthiness and the associated

[19] This includes Commission infringement proceedings under Art 228, preliminary references under Art 230, the information reporting requirements contained in numerous secondary instruments, and the information gathering function of European agencies such as the European Environmental Agency. For a treatment of Arts 228 and 230 as monitoring and sanctioning mechanisms, see J Tallberg, 'Paths to Compliance: Enforcement, Management, and the European Union' (2002) 56 *International Organization* 609.

[20] This refers to the safeguard clauses contained in the vast majority of harmonisation measures.

[21] Importantly, the governance structures established under most European instruments do not entail outright delegations of power to the Commission. Although the Commission has both the power of proposal and, as chairman of comitology committees, the power to call votes, it has neither the information necessary to draft the proposal nor the vote. In drafting proposals, the Commission relies on national experts for technical information and anticipates their positions in committee meetings.

[22] The role of beliefs and norms is hotly contested in the institutional economics literature. See M Levi, 'When Good Defenses Make Good Neighbors' in C Menard (ed), *Institutions, Contracts, and Organizations: Perspectives from New Institutional Economics* (Colchester, Edward Elgar, 2000). Scholars of network forms of economic organisation have relied most heavily on norms of reciprocity and beliefs of trust and obligation in defining and explaining the network form. See J Podolny and KL Page, 'Network Forms of Organization' (1998) 24 *Annual Review of Sociology* 57.

[23] See M Bacharach and D Gambetta, 'Trust in Signs' in K Cook (ed), *Trust in Society* (New York, Russell Sage Foundation, 2001).

willingness to cooperate is greater than the sum of institutional incentives.[24] X might trust Y because Y is from the same club or university, or is part of a network of committed regulators which meets regularly and publishes in the same journals.[25] Or X might trust Y because Y displays all the external signs of the underlying dispositions and skills that make her trustworthy, say, the right handshake or the right meeting agenda.[26] And the more individuals trust, the more other individuals have an incentive to develop reputations of trustworthiness, since it becomes increasingly likely that a reputation for trustworthiness will be rewarded with trust.[27]

At the root of the analogy between European governance and collective action games, between government officials regulating the common market and firms engaging in an asset transfer, lie two basic similarities. First, both entail a long term relationship marked by repeated interactions with the corresponding risks of opportunism, namely the failure to fulfil promises, disclose true conditions, or negotiate incomplete terms in good faith. Cooperation among government regulators must be continuous if British beef is going to get to the French butcher shop or Italian wine to the British pub. Second, neither in European governance nor in collective action games is there a commonly recognised legitimate authority, ie hierarchy, able to settle disputes over interpretation, information, and defection. There is not – at least not yet – a Prime Minister for Europe, just as there is no Chief Executive Officer for inter-firm transactions.

Let me pause to underscore the limits of the contract analogy. Firms are assumed to engage in profit maximising behaviour in the context of a functioning market for goods and services. In negotiating mutually beneficial contracts, their preference is profit maximisation. By contrast, the preferences of regulators are vastly more complex. Regulators are supposed to

[24] See M Levi, 'When Good Defenses Make Good Neighbors' in C Menard (ed), *Institutions, Contracts, and Organizations: Perspectives from New Institutional Economics* 142 (Colchester, Edward Elgar, 2000). Levi gives a helpful definition of trust :

> Institutions, including but not limited to those producing credible commitments, influence expectations, based on knowledge, that the trusted will not harm the trustor. Trust informs the act of taking a certain kind of risk, of making oneself vulnerable by '… voluntarily placing resources at the disposal of another or transferring control over resources to another …' Trust affects the trustor's calculation concerning the probability that she will be better off, or at least not worse off, as a result of taking a risk. Trust is not, however, either the risk-taking behaviour or the calculation about whether to take a risk; it is a belief that informs the decision on how to act.

[25] See KS Cook and R Hardin, 'Norms of Cooperativeness and Networks of Trust' in M Hector and K-D Opp (eds), *Social Norms* (New York, Russell Sage Foundation, 2001).
[26] See M Bacharach and D Gambetta , 'Trust in Signs' in KS Cook (ed), *Trust in Society* (New York, Russell Sage Foundation, 2001) 154.
[27] E Ostrom, 'Toward a Behavioral Theory Linking Trust, Reciprocity, and Reputation' in E Ostrom and J Walker (eds), *Trust & Reciprocity* (New York, Russell Sage Foundation, 2003) 49–54.

serve as agents for the national interest, but of course national interest is an indeterminate process of elections, political parties, social mobilisation, and interest group representation. In any given case, a regulator's preference might be a reflection of administrative tradition and culture, ministerial directions, national interest group politics, or simply personal predilection. Moreover, even if it were possible to conceptualise regulatory preference as the maximisation of a single national interest, knowing how to do so through the regulatory bargain is not easy. Does a licensing scheme or a tough administrative sanctions regime, a 'reasonableness' or 'proportionality' standard, 10 or five meat packing plant inspections per year, advance the national interest?

Second, in regulatory relations, the difficulty of fully specifying the terms of the bargain *ex ante* is of an entirely different order than in contract. In regulatory relations, not only are certain contingencies difficult to anticipate, but the national response to the event is unpredictable. Take beef safety. Before the mad cow crisis, there was no European standard on testing cows for BSE before slaughter, but now one in every three cows is tested. The European livestock directives were incomplete not only because regulators did not think that Creutzfeld-Jacob Disease could be transmitted to cows and through cows to humans, but also because they did not know what level of risk their national consuming publics would tolerate when confronted with BSE. Was the test to be done on each and every cow, one out of every three cows, or one out of every ten?

The last point of clarification relates to the concept of opportunism, as used in the contract literature, or defection, as used more generally in the game theory literature. While in contract, the term opportunism denotes deceitful or selfish behaviour, in European regulatory relations the term carries no such meaning. The possibility of behaving opportunistically is simply a device for conceptualising the journey from Brussels back home to the national capital. A treaty, a directive, or an implementing rule contains multiple commitments to reallocate public resources, favour certain domestic constituencies over others, and subscribe to certain ideals over others. It is not easy for national regulators — part of entirely different political and administrative apparatuses — to honour these commitments. Likewise, the renegotiation of the incomplete terms of the European instrument represents a fresh opportunity for regulators to advance national interest and hence behave strategically through the use of asymmetric information and bargaining tactics.

The Example of Free Movement of Broadcasting Services

In 1998, the British government banned the porn programme 'Eurotica Rendez-Vous Television.' The satellite broadcaster, a Danish firm, challenged

the British decision in national court and the Commission's decision upholding the British ban in the Court of First Instance.[28] The Danish firm was unsuccessful in both venues. In this section, I use the *Eurotica Rendez-Vous Television* case and the legislative framework for trade in broadcasting services to illustrate the institutions, norms, and beliefs critical to European integration. Only through a combination of iterated games, monitoring, sanctions, credible commitments, alternative governance mechanisms, and trust has a common market in television programming gradually developed and Danish broadcasting reached, at least some of the time, British viewers.

The story of free movement of porn shows starts not with *Eurotica Rendez-Vous Television* but with the EC Treaty in 1957. Article 49 ECT guarantees free movement of services, including broadcasting services. However, the numerous national rules on matters such as advertising, local and national content requirements, and public decency prevented television shows produced for one market from reaching other markets. Only a handful of cases challenging trade-restrictive national rules were brought before the Court of Justice and in only one was the foreign broadcaster successful.[29] Therefore, in 1989, the Member States negotiated the Television Without Frontiers Directive, laying down certain common rules on cultural policy, television broadcasting of films, advertising, protection of minors, and hate speech.[30] Member States must ensure that national broadcasters respect the directive's common rules and, in return, national programming can circulate freely throughout the other Member States. Because the directive contained only a skeletal framework for broadcasting regulation, national regulators agreed, in the text of the directive, to periodically review its application and to negotiate more precise terms where experience showed that national regulatory differences continued to block the free circulation of programming.[31]

Disputes over the meaning of the terms of the Directive are settled through amendments to the basic legislation, interpretive rules, enforcement consultations and, sometimes, in court. Following the periodic review described above, a number of amendments were negotiated in 1997.[32] A committee of national broadcasting regulators regularly confers and

[28] Case T-69/99 *Danish Satellite TV (DSTV) A/S (Eurotica Rendez-Vous Television) v Commission* [2000] ECR II-4039.

[29] See Case 352/85 *Bond van Adverteerders v Netherlands* [1988] ECR 2085; Case 262/81 *Coditel SA v Cine-Vog Films* [1982] ECR 3381; Case 62/79 *SA Compagnie generale pour la diffusion de la television v Cine Vog Films* [1980] ECR 881; Case 52/79 *Procureur du Roi v Debauve* [1980] ECR 833.

[30] Council Directive 89/552/EEC of 3 October 1989 on the coordination of certain provisions laid down by Law, Regulation or Administrative Action in Member States concerning the pursuit of television broadcasting activities [1989] OJ L298/23.

[31] *Ibid*, Art 26.

[32] European Commission, Report on Application of Directive 89/552 (May 1995); Directive 97/36/EC of the European Parliament and of the Council of 30 June 1997 amending Council Directive 89/552/EEC on the coordination of certain provisions laid down by law, regulation

hammers out differences that surface in the Directive's application.[33] A programme which, according to the receiving Member States, should have been prohibited by the transmitting state because it breaches the Directive's standards may be banned after regulators in the receiving country consult with regulators in the transmitting country.[34] Whether the national act represents a permissible public policy measure, in furtherance of the Directive's rules on public decency, or an illegal discriminatory trade barrier, may be highly contested, not least because the Television Without Frontiers Directive does not lay down standards on pornography and violence harmful to minors.

In other words, the very meaning of the Directive is worked out in enforcement negotiations. The Commission takes part both in negotiations over more precise standards in the committee of national broadcasting regulators and in the interpretation and application of such standards in individual cases, but its authority is not well-defined. As chair of the committee, the Commission representative does not have a vote. In disputes over national programming bans, the Commission is notified of the ban and is required to ensure the compatibility of the ban with terms of the Directive, but the legal effect of the Commission's finding remains unclear.[35]

Returning to the *Eurotica Rendez-Vous Television* case, the Danish Satellite and Cable Board licensed the broadcaster of the pornography programme.[36] The UK Secretary of State for Culture, Media and Sport, however, believed that Eurotica Rendez-Vous Television contravened the Directive's prohibition on pornography harmful to minors, notified the Commission to that effect and, upon receiving no response from the Danish authorities, banned the programme.[37] The Commission later found the Secretary's decision to be consistent with the Directive, since the measure did not discriminate against Danish broadcasters and was appropriate for

or administrative action in Member States concerning the pursuit of television broadcasting activities [1997] OJ L202/60.

[33] Directive 89/552/EEC as amended by Directive 97/36/EC, above n 32, Art 23a.

[34] In regulatory schemes without safeguard clauses, however, the Court has found that other regulators may not dispute enforcement of the standard through export or import bans. See Case C-594 *Hedley Lomas* [1996] ECR I-2553.

[35] Above, n 32, Directive 97/36/EC, Art 2.2a; Case T-69/99 *Danish Satellite TV (DSTV) A/S (Eurotica Rendez-Vous Television) v Commission* [2000] ECR II-4039, para 10 ('[b]y an act referred to as a decision … the Commission took the view that the measures adopted by the Member State concerned were not discriminatory … ').

[36] The programme, Eurotica Rendez-Vous Television, was produced in France, subscriptions were sold to viewers by Rendez-Vous, a company with offices in France and Luxembourg, and the channel was broadcast by way of satellite by DSTV, a Danish company.

[37] The relevant provision of the Directive reads:

> Member States shall take appropriate measures to ensure that television broadcasts by broadcasters under their jurisdiction do not include any programmes which might seriously impair the physical, mental or moral development of minors, in particular programmes that involve pornography or gratuitous violence.

protecting minors under the principle of proportionality.[38] The Danish broadcaster (DSTV) challenged the Secretary's Order in UK court and contested the Commission's decision in the Court of First Instance but was unsuccessful in both venues. The UK High Court found that the Secretary of State had exercised his discretion reasonably in determining that Eurotica Rendez-Vous was harmful to minors.[39] The Court of First Instance rejected the challenge to the Commission's decision on justiciability grounds. The Court found that the Directive entrusted national governments with licensing and pornography decisions, not national governments in conjunction with the Commission or the Commission alone. Therefore, the Commission's decision did not have a 'direct' effect on DSTV: the decision was 'limited merely to pronouncing ex post facto on the compatibility with Community law of the [UK] Order.'[40] DSTV was harmed by the British administration's decision to prohibit the programming, not by the Commission's finding of compatibility, which, in the Court's view, simply allowed the national act to stand. DSTV's only remedy therefore lay against the British government in national court.[41]

Lessons for European Governance

This discussion of the regulatory framework for broadcasting services highlights several aspects of European governance. Most importantly, bargaining among national regulators characterises every phase of the decision whether to allow a television show to circulate freely. Regulators negotiate

Directive 89/552/EEC as amended by Directive 97/36/EC, above n32, Art 22. Interestingly, even in a globalised, high-technology world in which activities like satellite broadcasting can move effortlessly between borders and escape the control of government, national authorities have not entirely lost their ability to regulate. In this case, since the programming was encrypted before being beamed via satellite, it could only be viewed with a receiver decoder and a smart card at the consumer's home. Under the Foreign Satellite Service Proscription Order, it became an offence to supply the equipment, advertise, or publish programming times in connection with Eurotica Rendez-Vous Television.

[38] See Case T-69/99 *Danish Satellite TV (DSTV) A/S (Eurotica Rendez-Vous Television) v Commission* [2000] ECR II-4039, para 10.

[39] *R v Secretary of State for Culture, Media and Sport ex parte Danish Satellite Television A/S and Rendez-Vous Television International SA* [1999] EWHC Admin 132 (12 February 1999). The administrative law grounds considered by the court were: necessity, proportionality, Wednesbury reasonableness, the duty to give reasons, and discrimination on the basis of nationality.

[40] Case T-69/99 *Danish Satellite TV (DSTV) A/S (Eurotica Rendez-Vous Television) v Commission* [2000] ECR II-4039, para 27.

[41] This is the question of reviewability which is distinct from standing even though they both are jurisdictional issues and fall under Art 230. Even if a Community act is found to be reviewable, the party bringing the challenge may not have standing, ie be the correct party to bring the action, because he or she is not individually affected.

the Treaty article, the Directive, the standards, and the application of the standards. To translate this into the conceptual language of a national polity, in the European Union regulators negotiate everything from the constitutional article, to the legislation, to the administrative rules, to the enforcement of those rules. It is misleading to frame the decision to ban Eurotica Rendez-Vous Television as routine 'enforcement' or 'implementation' of the rule contained in the Treaty or the Television Without Frontiers Directive. While concepts such as enforcement and implementation are tied to organisational hierarchy, there is in Europe no prime minister who can tell the Danes to ban Eurotica Rendez-Vous or the Brits to accept it. There is no political superior armed with the formal and informal constitutional tools typically used in ensuring a certain level of commonality in interpreting and applying broadly worded norms. No 'European' prime minister can remove recalcitrant administrators, shift budget priorities, deprive uncooperative elected officials of party funds, or damage professional reputations.[42] Of course, not even in a domestic polity are the law on the books and the law as applied the same, but the distance between the norm and the reality and the process by which the norm becomes a reality are fundamentally different in Europe. Because European governance is about repeated regulatory exchanges, whether British viewers will get to see any Danish porn depends on cooperation between British and Danish regulators in hammering out the thorny issue of what is legitimate trade in services and what is corruption of minors.

Second, the exchange dynamic characterises everything from formal, inflexible legal instruments to informal understandings as to interpretation. The more formal the terms of the bargain, the higher the stakes, since those terms may be given greater weight by the courts and be extremely difficult to change. Likewise, the more formal and law-like the instrument, the greater the influence of actors other than civil servants — actors such as ministers, parliamentarians, interest groups, and courts — since the significance of the decision, as well as the simple fact that a decision is being made, is more readily apparent. But the core integration process — regulatory cooperation — remains the same.

Third, integration of the European market for broadcasting services depends on strategies of reciprocity, cooperation and trust among regulators. European regulators engage in repeated exchanges, both within the same policy area, as the broadcasting example demonstrates, and across different policy areas. Consequently, they can credibly threaten defection with defection. If one party cheats on a promise, for instance Britain blocks Danish broadcasting because it contains a kiss then Denmark might next

[42] For a comparison of the different constitutional doctrines that shape US federalism and EU governance, see D Halberstam, 'Comparative Federalism and the Issue of Commandeering,' in K Nicolaidis and R Howse (eds), *The Federal Vision: Legitimacy and Levels of Governance in the US and the EU* (New York, Oxford University Press, 2001).

block programming from Britain containing a racial slur. The British reason, that the programme 'offended public decency,' would appear to be a pretext for promoting British over Danish programming, and might be followed by a similarly questionable Danish ban, based on the claim that a racial slur is 'incitement to hatred on grounds of race.' The same tit-for-tat logic applies to successive bargaining rounds on, say, what constitutes 'safe' programming. Should one party fail to renegotiate an incomplete term in the Directive in good faith, she faces the prospect of retaliation. For instance the British regulator on the comitology committee exaggerates the national abhorrence for pornography in setting standards on programmes harmful to minors, then when it comes to setting standards for programmes which can cause incitement to hatred, the Danish regulator might choose to exaggerate the strength of her domestic neo-Nazi movement. Over time, through repeated exchanges, the credible threat of defection might also be supplemented by beliefs of trust. When repeated dealings allow regulators to demonstrate a commitment to reciprocity, they may begin to cooperate without attention to the next round or threat of retaliation, simply because they believe that other regulators will also do so. This belief is what analytical sociologists would call trust.

Fourth, the Commission, litigants and courts constitute the essential institutional apparatus, without which regulatory cooperation would advance only slowly or not at all. They play a critical role in providing reliable information on cooperation or defection and eventually in sanctioning defection. National regulators make decisions on implementation and enforcement in part in anticipation of being sued and, once a lawsuit is brought, courts can interpret European instruments to favour European over national interests. Regulators from one country trust regulators from other countries because they know they are subject to the same constraints. Nevertheless, given the complexity of administering the common market, the Commission and the courts can only facilitate, not actually force, cooperation.

The role of the judiciary in this account of integration may, coming from a jurist, sound surprisingly limited. It is therefore important to be clear about the exact reasons for these limits. Because litigation is expensive and jurisdictional rules are restrictive, plaintiffs may have a hard time getting into court and calling their national governments to task for maintaining discriminatory rules. Sometimes plaintiffs simply fail to raise points of European law.[43] The authority of the Commission and the Court of Justice is still contested.[44] National courts do not always make preliminary references or apply European law. National governments do not always comply

[43] See Case C-430/93 *Van Schijndel v Stichting Pensioenfonds voor Fysiotherapeuten* [1995] ECR I-4705.

[44] On the difficulties of establishing judicial authority in the Community, see JHH Weiler, 'The Transformation of Europe' (1991) 100 *Yale Law Journal* 2403. On the difficulties of establishing the Commission's authority, see K Van Miert, *Le marché et le pouvoir* (Paris, Editions Racine, 2000).

with decisions of the Commission or rulings of the ECJ. Courts and governments may sustain reputational and other costs when they do not follow the case law of the Court of Justice or abide by Commission decisions, but that does not mean that they actually comply. To rephrase the problem in American 'legalese,' a frustrated Court of Justice cannot issue a writ of mandamus, ordering the national judge or official to comply or else face imprisonment for contempt of court.

The more circumscribed role for courts in this account of integration is also linked to the regulatory bargains they are charged with enforcing. Courts face two significant institutional hurdles in establishing uniform sets of rights under European law. First, even when the legal instrument is complete, information on cooperation or defection is sometimes knowable only to national regulators. Administrative decision-making is notoriously invisible and difficult to police, even for courts operating in the very same national tradition as an administrative agency. It is therefore unrealistic to expect that they will be able to discern whether, say, the British Secretary of State was protecting the legitimate interests of British children or the illegitimate interests of his broadcasting industry. To illustrate the problem of observability and verifiability in contract law, Steven Shavell uses the example of a contract between a photographer and a couple for taking photographs on their wedding day.[45] Whether the photographer develops a stomach-ache on the day of the wedding is certainly relevant to the contract, but unless the condition is very severe, only the photographer will know whether she has a stomach ache. Even if the couple could also know, say from her tone of voice when calling to cancel on the morning of the wedding, it would be difficult to prove in court. Likewise, in European law, whether European standards are being applied impartially to both domestic and foreign producers, or are being interpreted in the spirit of the legislation, is difficult for a court to discern. The responsible national administration will know, and other national administrations — given their repeated dealings and familiarity with the regulatory area — might very well know, but proving defection in court can be difficult or even impossible. In *Eurotica Rendez-Vous Television*, the UK court reviewed the administrative record, found that the Secretary of State had personally viewed the Danish programming to make the determination under the Directive, and upheld the ban. Yet how sure can a court be that, faced with identical British programming, the Secretary's decision would have been the same?

Moreover, to the extent that the legal instrument is incomplete, courts are reluctant to intervene and force an exchange upon the parties in which one regulator is required to renounce authority to another. The Treaty and

[45] S Shavell, *Foundations of the Economic Analysis of Law* (Cambridge, Harvard University Press, 2004). I am thankful to Henry Hansmann for bringing the problem of information in contract enforcement to my attention, together with the possibility of using rules of evidence to alleviate information problems, addressed in the last section of this chapter.

European laws contain open-textured language which leaves room for conflicting national regulation. Courts are often reluctant to impose one national approach over another in what would amount to finding an agreement to harmonise when, for that particular good or service, no such agreement had in fact been reached.[46]

On this point, it is helpful to recall that neither the Commission nor the courts in the *Eurotica Rendez Vous Television* case decided the question of what type of pornography is harmful to minors under the Television Without Frontiers Directive, and neither chose to exercise its authority to require the Danes to ban the programming or the British to accept it. The terms of the Directive were ambiguous and the Danish authorities were allowed to exercise their discretion to license Eurotica Rendez-Vous Television, and the British to ban it. This deference to administrative interpretations of broadly worded statutes is typical of the relationship between courts and administrative agencies. Nowhere in Europe do judges, in reviewing public decision making, decide whether the government made the right decision. They do not ask whether the scientific facts were accurate or the agency's interpretation of the legal standard correct. In the UK, judges examine government decisions for 'reasonableness,' in France for 'manifest error of evaluation,' and in Germany for 'abuse of discretion.' Given the institutional limits of courts, until British and Danish regulators decide otherwise, they will continue to agree to disagree and a common market in programmes like Eurotica Rendez-Vous will not exist.

Another lesson to draw from European regulation of broadcasting services is that, through repeat interactions, players are not only assured of cooperation, but they develop more robust definitions of what is cooperation and what is defection. Over time, the players learn to recognise a wider range of national regulatory activity as either 'cooperation' or 'defection.' This is the equivalent of striking a series of more detailed bargains to fill in the terms of the incomplete contract initially negotiated. One might think of European governance in this regard as a process in which an initially small core of covered activity — both of regulator and regulated — gradually expands through repeated regulatory interactions, and in doing so squeezes out purely national decision making. From the perspective of one of the 15 Member States, this is a process in which a large ring is drawn; the activity outside of the circle is proscribed by the European norm, while the activity within the circle is purely discretionary and thus a matter of national choice. As integration progresses, the ring tightens and the zone of national autonomy is squeezed. The more loosely defined the norm, written

[46] For another skeptical view of the courts' ability to achieve market integration, see M Everson 'The Crisis of Indeterminacy: An 'Equitable' Law of Deliberative European Administration?' in C Joerges and R Dehousse (eds), *Good Governance in an 'Integrated' Market* (Oxford, Oxford University Press, 2002). Everson, however, focuses on the doubtful moral authority of the courts in settling regulatory matters.

or unwritten, the smaller the core of covered activity, while the more fine-grained the norm, the larger the core. And even though the norm may become more fine-grained, it does not necessarily result in harmonisation or uniformity; indeed it might require pluralism, since, over time, different national practices come to be recognised as protecting similar values. Through this process, regulators as well as the national communities in which they operate develop European as opposed to purely national conceptions of interest and value. Nevertheless, as long as regulators remain part of different political, administrative, and cultural elites, at the margin of the expanding core or the narrowing ring, they will continue to behave strategically.

To illustrate once again with the broadcasting example, the British regulator wishes to promote her broadcasting industry while, at the same time, not incur the wrath of angry parents who believe that their children are being corrupted by pornography. The same goes for the Danish regulator. They negotiate the Television Without Frontiers Directive. The Directive says nothing as to what type of programming is likely to be harmful to minors. It seems pretty clear that, for example, documentaries on World War II, on the one hand, or bestiality, on the other, should be covered under the Directive: the British regulator must license documentaries on World War II, regardless of their origin, while the Danish regulator must not license programming with bestiality, regardless of its origin. But what about matters in between? British and Danish parents may have different views as to what type of shows will disturb children, but how different are those views? Perhaps British parents can only know their views once they have actually been exposed to Danish broadcasting since, for longstanding historical reasons, an equivalent British industry never developed. In their dealings with one another, in negotiating, say, encryption requirements for certain types of shows or, in banning certain programming as in the *Eurotica Rendez-Vous Television* case, the British regulator will legitimately resist renouncing her authority over programming which offends her parent population, albeit at the expense of her broadcasters, and vice versa for the Danish regulator. At the same time, the regulator might defect by exaggerating the sensitivity of parents to certain types of shows which happen to be foreign, or by simply scrutinising foreign broadcasts more rigorously than local ones. In these repeated dealings, as regulators renegotiate the boundaries separating legitimate retention of regulatory authority from illegitimate discrimination against foreign broadcasters, they develop European values concerning the types of influences likely to be harmful to child development.

The lessons learned from the regulation of broadcasting apply to virtually every area of European policy making and administration. Regulatory cooperation and trust are critical to monetary policy, product safety, food safety, telecommunications, the designation of protected labels, licensing of genetically modified organisms, pharmaceuticals, sex and race

discrimination, and more.[47] This regulatory dynamic is critical to European instruments and institutions which, when viewed from the traditional perspective of a nation state, would suggest centralised as opposed to fragmented authority. A Council and Parliament directive, a Commission implementing rule, even a Commission decision, is generally the product of consultation among national regulators, not the bureaucratic decision making of a single public administration. The Commission (most visibly in those areas where comitology committees exist), European agencies, and even the European Central Bank operate on the basis of regulatory cooperation rather than administrative hierarchy.[48] To the extent that these European institutions exercise administrative authority — and it is important to keep in mind that the majority of what are called agencies only have information gathering responsibilities — they are significantly constrained. The Commission, the European Medicinals Evaluation Agency and the European Central Bank rely heavily on national administrations, both for information, in the form of technical expertise and self-reporting, and for decision making, in that most measures must be approved by a majority of national regulators on the committees.[49] Moreover, with the possible exception of competition law and anti-fraud investigations,[50] no European institution has powers of direct application and enforcement of European

[47] For an especially comprehensive and acute analysis of shared administrative authority, see S Cassese, *Lo spazio giuridico globale* (Bari, Gius. Laterza & Figli, 2003) and S Cassese, 'Il diritto amministrativo europeo presenta caratteri originali?' (2003) 1 *Rivista trimestrale di diritto pubblico* 35. See also G della Cananea 'I procedimenti composti dell'Union europea' (paper presented at conference held at Università di Roma 'La Sapienza' 8 April 2003); C Joerges, 'Law, Science and the Management of Risks to Health at the National, European and International Level — Stories on Baby Dummies, Mad Cows and Hormones in Beef' (2001) 7 *Columbia Journal of European Law* 1; G Majone and M Everson, 'Institutional reform: independent agencies oversight, coordination and procedural control' in O De Shutter et al (eds), *Governance in the European Union* (Brussels, European Commission, 2001) (telecommunications, pharmaceuticals, foodstuffs, and electricity).

[48] On the decentralised nature of the European Central Bank as compared to the US Federal Reserve, see S G Cecchetti and R O'Sullivan, 'The European Central Bank and the Federal Reserve' (2003) 19 *Oxford Review of Economic Policy* 30. For a comprehensive and illuminating analysis of the 'joint exercise of Community functions' through European agencies, see E Chiti, 'Decentralized Integration as a New Model of Joint Exercise of Community Functions: A Legal Analysis of European Agencies' (2003) *European Public Law Review* (forthcoming, copy on file with author). See also G Majone, 'The Credibility Crisis of Community Regulation' (2000) 38 *Journal of Common Market Studies* 273.

[49] The only European institution which does not fit this mould is the European Office for Harmonization, which operates as an administrative tribunal. The European officials who staff the Alicante headquarters decide, through an adversarial process, whether a given design or logo should be awarded a European trademark, and the parties may appeal the finding to the Court of Justice.

[50] However, even when Commission officials investigate competition law infringements and claims of embezzlement of Community funds, they must act through local administrative authorities in obtaining search warrants and conducting other enforcement activities. See Council Regulation (EC) 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (Text with EEA relevance) [2003] OJ L1/1, Art 20.6.

law. Thus, regulatory cooperation of the sort which occurs under the Television Without Frontiers Directive is critical in virtually all European policy areas.

THE RELATIONSHIP OF THE COLLECTIVE ACTION APPROACH TO OTHER THEORIES OF EUROPEAN INTEGRATION

The collective action understanding of European governance draws upon the institutionalist tradition in international relations scholarship, but it also develops new concepts based on my observation of the institutions which have facilitated an unprecedented level of cooperation among EU Member States. This is not the place to survey comprehensively the vast literature in both international relations and European integration. But, to give a better idea of what enlargement means for European governance through collective action games, I briefly situate my approach in the canon and, in doing so, relate my assessment of enlargement to the other contributions in this volume.[51] First, I review the intergovernmental analysis of European integration and explain that the regulatory trust approach uses many of the same game theory tools, but sees a greater role for sector-specific regulators

[51] In this contribution, I conceptualise European governance with the limited purpose of explaining what makes European institutions work and deriving predictions and prescriptions for enlargement. Although terms like 'cooperation,' 'reciprocity,' and 'trust' in everyday usage carry normative overtones, I do not employ them in that sense here. I do not address the question of whether the process of regulatory cooperation is a legitimate one or whether the end result of cooperation, namely the single market and other areas of collective governance, is always a desirable one. My conceptualisation, however, is relevant to normative theories of European administration in that it suggests that the combination of indeterminate legal instruments and the absence of bureaucratic hierarchy give rise to an administrative system defined by regulatory negotiation. Therefore, to the extent that normative assessments are derived from the procedural aspects of transnational regulatory cooperation, as opposed to the substantive learning specific to certain types of regulatory cooperation , this papers shows that such normative assessments are broadly applicable to European governance. For instance, if as Christian Joerges argues, national regulators engage in deliberative supranationalism when they sit on comitology committees, then they also do so when applying European norms at home. See C Joerges, 'Deliberative Supranationalism — Two Defences' (2002) 8 *European Law Journal* 133; C Joerges and J Neyer, 'From Intergovernmental Bargaining to the Deliberative Political Process: The Constitutionalisation of Comitology' (1997) 3 *European Law Journal* 273. And if national regulators engage in experimentalism in developing policy targets and alternative means of achieving those targets through the Open Method of Coordination, so too do they in drafting market-creating harmonisation measures. See C Sabel and J Cohen, 'Sovereignty and Solidarity in the EU' in J Zeitlin and T Trubek (eds), *Work and Welfare in Europe and the US* (New York, Oxford University Press, 2003). This is not to deny that classic instruments like directives and regulations are different from the new instruments of Council guidelines and Commission reports but to say that they fall along a continuum. On OMC, see G de Búrca, 'The Constitutional Challenge of New Governance in the European Union' (2003) 28 *European Law Journal* 814 and J Scott and D Trubek, 'Mind the Gap: Law and New Approaches to Governance in the EU' (2002) 8 *European Law Journal* 1.

and their incremental development of European norms. I then sketch the neo-functionalist alternative and show how this paper, while sharing certain similarities, places greater weight on national politics in explaining common market integration.

Intergovernmental Theories of European Integration

In international relations, policy areas like trade, environmental protection and defense are routinely framed as prisoner's dilemma or other types of games, in which states would do better cooperating, yet, because of the structure of the interaction, fail to do so. One of the purposes of international regimes is to alleviate collective action problems by providing states with information on cooperation and defection, making it more likely that defectors will suffer retaliation and that cooperators will benefit from cooperation in kind.[52] An international secretariat with a full time staff and adequate funds can monitor individual countries and disclose information on their behaviour to other countries, which can then reciprocate either through cooperation or defection. In this vein, some scholars employ a thicker model of the domestic political process and the transnational mobilisation of private actors to argue that a defecting country can expect to face pressure not only from other states, but also from local and foreign interest groups, social movements, foreign lender banks, and so forth.[53] In certain, rare cases, an international secretariat is authorised to make definitive determinations as to whether states have defected or cooperated and to decide upon an appropriate sanction. For instance, the World Trade Organization Secretariat conducts periodic reviews of individual countries for compliance with the WTO agreements (the so-called Trade Policy Review Mechanism), while the WTO Dispute Settlement Body decides on defection and the level of retaliation warranted. By facilitating repeat plays among states and providing assurances of monitoring and sanctioning, the international regime guarantees that, in the short run, states will not engage in opportunism and that, in the long run, they will improve common, national interests.

[52] R Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton, Princeton University Press, 1984); R Axelrod and R Keohane, 'Achieving Cooperation under Anarchy: Strategies and Institutions' in K Oye (ed), *Cooperation under Anarchy* (Princeton, Princeton University Press, 1986).

[53] In the international law literature, see A-M Burley, 'Law Among Liberal States: Liberal Internationalism and the Act of State Doctrine' (1992) 92 *Columbia Law Review* 1907; HH Koh, 'Transnational Legal Process' (1994) 75 *Nebraska Law Review* 181; LR Helfer and A-M Slaughter, 'Toward a Theory of Effective Supranational Adjudication' (1997) 107 *Yale Law Journal* 273.

The intergovernmental perspective has particularly influenced one line of thought on the reasons for the establishment of the European Community and on the role that European institutions currently play in making the common market work. The leading proponent of this view in the American academy, Andrew Moravcsik, argues that substantive and institutional dimensions of each of the major agreements in the history of the European Community can be explained as the result of state interest.[54] The Member States sought to enhance their collective welfare by agreeing to pool sovereignty in certain policy areas, while at the same time using their relative bargaining positions to alter distributional outcomes. For purposes of this chapter, what is most relevant is Moravcsik's characterisation of the institutional innovations in each bargaining round as the consequence of the long term interests of states. He argues that qualified majority voting and the Commission's power of proposal were introduced in the Treaty of Rome because the founding Member States wished to credibly commit themselves in those substantive areas where their interests — or at least those of the most powerful Member States — converged. In Moravcsik's view, the same was true for the extension of qualified majority voting in the Single European Act and the Maastricht Treaty as well as the establishment of the European Central Bank.[55] Following in this tradition, Jonas Tallberg argues for an institutionalist understanding of the current role of European institutions in the day-to-day business of European policy administration. He contends that recent improvements in Member State compliance rates can be attributed to the role of the Commission and private plaintiffs in monitoring state behaviour and the courts' role in sanctioning Member States for non-compliance.[56] Most recently, Mark Pollack has drawn on game theory analysis of American political institutions to take a close look at the many ways in which the Commission and the Court of Justice exercise delegated powers.[57] Pollack analyses the enforcement mechanism operated by the Commission and the Court, together with the Commission's agenda-setting and rule making powers. He convincingly demonstrates that the credible commitment logic as well as the need for quick and efficient decision-making have influenced the

[54] A Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (Ithaca, Cornell University Press, 1989).
[55] *Ibid* at 375, 467. G Majone has argued in favour of transferring powers to the Commission and European agencies based on the credible commitment logic. See G Majone 'The Credibility Crisis of Community Regulation' (2000) 38 *Journal of Common Market Studies* 273, 288. However, in his view, national politicians enter into credible commitments to reassure their citizens that they will pursue the long term interest of the polity rather than to reassure one another that they will cooperate.
[56] J Tallberg 'Paths to Compliance: Enforcement, Management, and the European Union' (2002) 56 *International Organization* 609.
[57] MA Pollack, *The Engines of European Integration: Delegation, Agency, and Agenda-Setting in the EU* (Oxford, Oxford University Press, 2003).

choice of when to delegate powers to European institutions and how to structure such delegations.

The premise of this chapter–that the Member States still retain their authority in fundamental ways and therefore regulatory cooperation is critical to European policy-making – is heavily influenced by intergovernmental theories. Nonetheless, my approach differs in that I take the grand bargain for what the international relations theorists say it is, nothing more and nothing less. It is a bargain situated in a regime which is still, in important respects, international, not federal, and therefore the shape of the bargain is constantly subject to re-evaluation and reinterpretation. Strategic behaviour continues well after the ratification of the treaty, the coming into force of the directive, and the opinion of the experts committee. My emphasis on the persistence of strategic behaviour in the 'low politics' of common market administration leads me to focus on a distinct set of institutions and practices which permit cooperation under conditions of anarchy.

How, then, do the institutions and practices which enable Danish programming to get to British television screens differ from those which led to the commitment to free movement of services in the Treaty or free circulation of television shows in the Directive? Unlike classic institutionalist theory, in which the actors are unitary states, in common market governance the players are civil servants. Their interactions are so frequent that agreement among them is not only memorialised in treaties or secondary instruments, but is also found in informal opinions and unwritten understandings about interpretation. Regulators negotiate not only the substantive meaning of the basic legal norms, but also the procedures through which they decide those substantive meanings. Directives are amended and working party rules of procedure modified so as to alter the balance of power between national regulators and the Commission. Since civil servants constantly renegotiate the terms governing a policy area, what was a concession in a previous round can become a preference in the current round. In other words, regulators gradually develop a European conception of interest and value, albeit still under pressure from their home governments, elites, and electorates to defect. Moreover, because of their frequent dealings and the dense, common cultural and institutional context in which they operate, regulators can develop trust. Under the right circumstances, they can stop behaving strategically and cooperate, not because of the fear of retaliation or sanctions, but because one party is trustworthy and the other party trusts.[58]

[58] My characterisation has a lot in common with Fritz Scharpf's analysis of European governance when acting in what he calls the supranational and joint decision modes. See F Scharpf 'What Have We Learned? Problem-Solving Capacity of the Multilevel European Polity' *Max Planck Institute for the Study of Societies* (Working Paper MPIfG 01 / 4 July 2001). Scharpf notes that

Neo-Functionalist Theories of European Integration

Intergovernmental explanations represent only one strand in the political science literature on European integration. Beginning with Ernst Haas, scholars have believed it necessary to look beyond myopic national interest to understand the development of the common market and European governance. Initially, the combination of technocratic policy entrepreneurs and producer groups were believed to impel integration. Technocrats would capably manage concrete, pan-European problems, and employer associations and trade unions would reap the benefits, leading in turn to political momentum for more technocratic supranational management, followed by more benefits for producer groups and so on, in a continuous feedback loop.[59] The Schuman Declaration is the classic expression of the early neo-functionalist view: the incremental successes of supranational expert administration would gradually lead to the decline of self-destructive nationalism and the rise of a federal-style European system.[60]

Although this early form of neo-functionalism was largely abandoned in the 1970's, the last 20 years have witnessed a rising tide of scholarship chronicling the power of economic actors, interest groups, courts, and the Commission in pushing forward collective governance where intergovernmental politics would have predicted stalemate. As in the earlier neo-functionalist literature, the state is eclipsed by supranational institutions and interest groups. According to Alec Stone Sweet and Wayne Sandholtz, the exponents of one of the most highly theorised examples of this scholarship, the process is as follows. Transnational economic actors and other civil society groups which stand to benefit from market liberalisation and, more recently, market-correcting measures, put pressure on supranational institutions (the Commission, the Court of Justice, and, now, the European Parliament)

European policy making on issues of negative market integration and harmonisation of product and process standards has been conducted mainly through these institutional modes. He claims that the success of European policy making in these areas can be explained as a function of states operating in a classic prisoner's dilemma game, promoting their shared interest in market creation. By contrast, the absence of EU welfare policies is a reflection of divergent state preferences for income redistribution and social protection. Given the collective action game premise of this paper, as in Scharpf's analysis, successful administration undoubtedly rests upon shared state interests. My analysis differs mainly in my focus on the institutional dynamics of European administration. Given the importance of repeat plays, regulatory cooperation, and trust, initial agreement over shared interest does not necessarily predict success and likewise, initial scepticism over shared interest does not necessarily predict failure.

[59] See J Monnet, *Mémoirs* (Paris, Fayard, 1976); EB Haas, 'International Integration: The European and the Universal Process' (1961) 15 *International Organization* 366.
[60] R Schuman, 'Paris Declaration of May 9, 1950' <http://dspace.dial.pipex.com/mbloy/hst/schuman.htm> (17 February 2004).

through their litigation and lobbying activities.[61] Those supranational institutions take the lead in establishing new rules and expanding collective governance into new areas. The increasingly dense fabric of rules serves to constrain national governments and to structure future interactions among transnational interest groups and branches of their national governments, on the one hand, and supranational institutions, on the other hand. The rules generate their own dynamic in favour of more European rules, not necessarily for the reasons that classic neo-functionalism posited, ie the growing benefits to certain producer groups, but because once a rule is chosen, the logic of path dependency drives social actors to choose a set of related rules rather than reassess the initial rule.[62] Much of the empirical research on the Commission, the Court of Justice and national courts, the Council, the European Parliament, and Brussels-based lobbies does not explicitly or implicitly endorse all elements of modified neo-functionalism. Nonetheless, at the risk of over-generalising, the growing consensus is that supranational institutions, and the interest groups and citizens which mobilise around and through them, matter and that they matter more than national political processes.

Like neo-functionalists, I conceive of integration as an incremental process in which previous successes can generate momentum for more collective European governance, albeit among national regulators rather than supranational officials and interest groups. Also, like neo-functionalists, I find that common European interests and values are generated through the daily operation of national and supranational public bodies, and not only through treaty making and direct bargaining among government ministers and heads of state. At bottom, however, my approach differs from neo-functionalism in that I conceive of integration as proceeding through coordination and cooperation among 15 different administrative and political systems rather than the construction of a single, federalist system. In my view, anarchy rather than hierarchy —15 firms engaging in mutually beneficial exchanges rather than a single integrated firm — is still the better metaphor. The continuing importance of national politics therefore cannot be underestimated.[63] It should be clear from all that has been said that by

[61] See A Stone Sweet et al 'The Institutionalization of European Space' in Stone Sweet, A et al (eds), *The Institutionalization of Europe* (Oxford, Oxford University Press, 2001); W Sandholtz and A Stone Sweet, 'Integration, Supranational Governance, and the Institutionalization of the European Polity' in W Sandholtz and A Stone Sweet (eds), *European Integration and Supranational Governance* (Oxford, Oxford University Press, 1998).

[62] JA Caporaso and A Stone Sweet, 'Institutional Logics of European Integration' in A Stone Sweet et al (eds), *The Institutionalization of Europe* (Oxford, Oxford University Press, 2001); P Pierson, 'The Path to European Integration: A Historical-Institutionalist Analysis' in W Sandholtz and A Stone Sweet (eds), *European Integration and Supranational Governance* (Oxford, Oxford University Press, 1998).

[63] For the different but consistent view that the democratic legitimacy of the European Union continues to flow from national constitutionalism, see P Lindseth, 'Delegation is Dead, Long

national politics I do not mean prime minister and government cabinet. Rather, I mean civil servants facing pressure from their governments, electorates, elites, and courts, civil servants who negotiate with other civil servants under similar pressures. In this view of integration, there are certainly interest groups and citizens who benefit from the collective European policies and vindicate such policies through politicians, administrators, and courts. But those European claims are still made primarily through national institutions. The national political process, not the Brussels complex, is therefore able to exert considerable control over the success or failure of such claims.

The corollary of the continuing importance of national politics in my understanding of European governance is the more limited organisational capacity of the two principal supranational institutions, the Commission and the European Court of Justice. To put it bluntly, the Commission, the European Court of Justice, and national courts are not as powerful as some of the literature would have it. As the broadcasting example illustrates, the Member States have yet to give the Commission the resources or the authority of a federal administration, complete with full time policy making experts, rule making powers, local branches, enforcement officers, and the power to impose administrative and/or criminal sanctions. With very few exceptions, national regulators sitting and voting on committees, not the Commission acting independently, are responsible for administrative rule making and interpreting primary legislation. And national regulators, acting in consultation with other national regulators and the Commission, are responsible for day-to-day enforcement.

Similarly, the European Court of Justice is still not a federal supreme court.[64] National courts do not always refer questions of European law to the ECJ and national governments and courts do not always comply with ECJ rulings. Most critically, as discussed in the previous section, courts can only go so far in constraining government action. Judicial review of government action can be demanding, but judges are not institutionally equipped to make many of the value judgments and scientific determinations necessary to apply national and European law. With their background rules of statutory interpretation, procedural rights, and reasonableness, courts may

Live Delegation: Managing the Democratic Disconnect' in C Joerges and R Dehousse (eds), *Good Governance in Europe's Integrated Market* (Oxford, Oxford University Press, 2001).

[64] As should be clear from the previous section, however, the monumental importance of the Court of Justice cannot be underestimated. See JHH Weiler, 'The Transformation of Europe' (1991) 100 *Yale Law Journal* 2403; KJ Alter, *Establishing the Supremacy of European Law: The Making of an International Rule of Law in Europe* (Oxford, Oxford University Press, 2001); M Shapiro and A Stone Sweet, *On Law, Politics & Judicialization* (Oxford, Oxford University Press, 2002).

be deciding more than they would like to believe, but they do not actually make decisions for government administrations. Furthermore, to the extent that national governments do not enforce European policies because they choose to dedicate their administrative resources to national priorities, private plaintiffs and courts will not pick up the slack. For a variety of reasons, an American-style litigation culture, in which private plaintiffs enforce regulatory statutes in the absence of government action, does not exist in Europe. The Commission has repeatedly encouraged private plaintiffs to enforce European rules in national courts, in competition law, consumer protection, and environmental law, but it simply has not happened. It is because of the limits of the Commission and European courts — and the resistance of national governments to improving their organisational capacity — that strategic interaction, cooperation, and trust among national regulators remain critical to European governance.

THE COLLECTIVE ACTION ANALYSIS OF THE CHALLENGES OF ENLARGEMENT

The Problem of Integrating New Regulators into Common Market Exchange Relations

A collective action analysis of European governance suggests that the most significant hurdle to a common market in a Europe of 25 will be the establishment of cooperative relations among regulators from new and old Member States. There are two principal challenges. First, existing regulators do not have faith in the capacity of Central and Eastern European regulators to administer the *acquis communautaire*. This could provoke retaliation or sanctions against the new states even where none is warranted, leading to the downward spiral and the defect-defect equilibrium predicted by game theorists. Second, enlargement will be accompanied by a significant shift in power relations between existing Member States and the accession states, which could hamper the initiation of cooperative regulatory exchanges.[65] After enlargement, old regulators (ie regulators in the existing Member States) gradually will lose their leverage over their Central and Eastern European counterparts and instead will have to rely on pure reciprocity in their exchanges with new regulators to achieve cooperation. The transition could be a difficult one, for power relations are not conducive to developing

[65] On the power dynamic in the enlargement process, see M A Vachudova 'The Leverage of Internationalizing Institutions on Democratizing States: Eastern Europe and the European Union' *Robert Schuman Centre for Advanced Studies* (Working Paper No 2001/33 European University Institute Fiesole 2001) and A Moravcsik and MA Vachudova 'National Interests, State Power, and EU Enlargement' (2003) 17 *East European Politics and Societies* 42.

either norms of reciprocity or trust. An existing regulator in any one of the numerous common market areas might continue to believe, incorrectly, that she can deprive her Central or Eastern European counterpart of certain benefits within that area on account of the overall advantages of membership. Conversely, because of certain abuses of power during the enlargement process, a new regulator might be too ready to see the legitimate regulatory concerns of old regulators as pretexts for blocking their markets, and respond with administrative trade barriers of her own. In other words, the lack of trust among Member States and candidate countries stemming from the pre-accession period, could hamper cooperative regulatory relations and the creation of an integrated market in post-accession Europe.

Lack of Confidence in the New Regulators

The lack of confidence in the ability of Central and Eastern European regulators to effectively implement European law can be traced to a number of sources, some of which are more legitimate than others. From the perspective of common market administration, this accession is particularly difficult for a number of reasons. In each policy area, 10 new sets of regulators from 10 different political traditions, not two or three as in past accessions, will be asked to join European administrative networks. This represents a new set of languages, legal cultures, political systems, and administrative hierarchies, all of which must be understood, in a very broad sense, by existing regulators, as well as by other new regulators. In collective action games, the ability to recognise whether another player is cooperating or defecting is critical and, in the common market after enlargement, that will require learning 10 new administrative and legal traditions, or from the perspective of the new regulators, 24 new administrative and legal traditions. Understandably, European regulators perceive that this will be difficult and will require time.

Furthermore, the new regulators will be asked to cooperate with their counterparts elsewhere in administering a huge legal apparatus covering everything from automobile safety to environmental protection. Only in the Swedish, Finnish, and Austrian accession were new officials integrated into such an extensive set of policy-making networks.[66] The earlier accessions — those of the United Kingdom, Ireland, and Denmark, Greece, and Portugal and Spain — all occurred at a time when the common market was rudimentary and most public policy was still largely national. Officials from those countries, therefore, were involved in developing many if not most of the norms — some of which are inscribed in secondary legislation and implementing rules, others

[66] Indeed, even then, under Agreement on the European Economic Area signed in 1991, Swedish, Finnish and Austrian regulators had already been participating in common market administration for a number of years.

of which are part of informal practice — which they now administer day in and day out. Central and Eastern European regulators will be asked to jump in, midstream, and learn the rules, written and unwritten, under which they are to exercise their public authority not as 'Hungarians' or as 'Slovakians' but as 'Europeans.'[67]

Moreover, Central and Eastern European civil servants have only recently begun to participate in international policy making efforts and thus have not yet developed trust relationships with other European regulators. During the iron curtain years, they were cut off from the robust regulatory discussion in the Organisation for Economic Co-operation and Development (OECD), the Council of Europe, and the different parts of the UN system. Therefore, to the extent that sub-communities of governmental officials develop social capital through interactions in these international settings, it does not yet fully extend to the new regulators. In 1995, when Sweden, Austria, and Finland joined, existing regulators could trust the new regulators because they had demonstrated their commitment in other networks, had contributed to the same academic and policy making journals, and had attended the same conferences. This cannot be said for the Central and Eastern European regulators. Lastly, the discrepancy in administrative and economic capacity which separates the new from the old Member States is more significant than in many of the previous accessions. Since the fall of Communism, the accession states have had to rebuild their market economies, their political institutions, their government administrations, and their court systems. Given that implementation of the existing body of European law requires extensive economic and administrative resources, the new Member States can expect difficulties.

The accession countries have undergone an extensive and intensely scrutinised process of reform to qualify for enlargement. The annual Commission reports on their progress and the regular visits of Western European experts to verify implementation are a remarkable and distinctive feature of this accession. After almost a decade of supervision and monitoring, the Commission became satisfied that most of the *acquis*, in most of the countries, had been transposed, that is, had become law on the books. It became satisfied that, with a few notable exceptions, basic human rights, democracy, and the rule of law were respected by governing elites in the enlargement countries. Nevertheless, the big question on everyone's mind remains how the law on the books will work on the ground.[68] As Gunter

[67] There has already been some collaboration under the Europe Agreements but it will be much more significant once accession occurs.

[68] The Commission's 2002 report on Hungary is indicative in this regard. Hungary is generally considered one of the most advanced in meeting the criteria for membership. Yet even Hungary is not viewed as having the judicial and administrative infrastructure required for full and vigorous enforcement of the *acquis*. See European Commission, 'Regular Report on Hungary's Progress Towards Accession' (2002) 109-10, 137.

Verheugen, Commissioner for Enlargement, said in the aftermath of the accession negotiations, the accession countries 'must continue to work 'ceaselessly' to put in place the administrative capacities and ensure that they will be able to implement the *acquis* correctly from 1 May 2004.'[69] To this end, the Commission has established an 'enhanced monitoring process,' which will continue up to enlargement. Through this program, the Commission will monitor enlargement countries' application of the *acquis*, requiring regular reports from the governments and sending experts to inspect their customs offices, slaughterhouses, dairies, local administrations, and so on.[70]

One sign of the collective nervousness in Brussels is the existence of far-reaching safeguard clauses in the Accession Treaty.[71] The Commission, responding to concerns in the Member States and reservations expressed in the Council's working group on accession, proposed a special safeguard clause in October 2002. Safeguard clauses have been included in previous accession treaties, but they were generally limited to economic disruptions caused by the common market. The traditional clause allows new and old Member States to block exports and imports temporarily in order to protect producers in vulnerable sectors of their economies and allow them to adjust gradually to the competition of the common market. By contrast, the safeguard clauses that are found in the Accession Treaty cover home and justice affairs as well as the common market, and they authorise Member States to take measures not only to protect their economic operators, but in response to any shortcoming in the implementation of the *acquis*. Moreover, the safeguard clauses only apply against the new Member States, meaning that a Central and Eastern European country is not authorised to block trade with an existing Member State on the very same grounds of failed implementation. Specifically, the clauses permit Member States, with the approval of the Commission, or the Commission on its own initiative, to stop trade with a new Member State in the face of evidence that the new Member State is delinquent in administering the *acquis*. The clause may be invoked during the first three years after enlargement, one year longer than provided for in earlier drafts.[72] However, unlike earlier drafts, the final version contains significant restrictions on the measures which may be taken in response to a new Member State's implementation lapse: there must be a 'serious breach' or 'imminent risk of such breach' and the measures taken

[69] *Agence Europe* no 8388 (29 January 2003) 14.
[70] *Agence Europe* no 8313 (7 & 8 October 2002) 8; *Agence Europe* no 8376 (11 January 2003) 7.
[71] See Act of Accession, Arts 37, 38, 39. I am grateful to Xavier Lewis for bringing the safeguard clauses, as well as a number of other points of European law, to my attention.
[72] *Agence Europe*, no 8313 (7 & 8 October 2002) 8; *Agence Europe*, no 8315 (10 October 2002) 5; *Agence Europe* no 8317 (12 October 2002) 10; *Agence Europe*, no 8328 (27 October 2002) 7.

in response must be 'proportional,' may 'not be invoked as a means of arbitrary discrimination or a disguised restriction on trade,' and must 'be maintained for no longer than strictly necessary.'[73]

Shift in Power Relations

The remarkable structural changes which have been achieved so far in the enlargement countries are largely the consequence of the enormous power differential separating existing and new Member States.[74] This power relationship, known in the political science literature as asymmetrical interdependence,[75] enabled the former effectively to impose extensive domestic reform on the candidate countries, all on the strength of the benefits that the accession states could expect from EU membership. Although existing Member States will gain improved access to new markets, enlargement countries stand to gain significantly more through the combination of access to markets and subsidies from the Common Agricultural Policy and the Structural and Cohesion Funds.[76] However, once May 2004 comes and goes, and the candidate countries accede, the power differential will dramatically narrow, for existing Member States will no longer be able to threaten candidate countries with exclusion from the common market. Within each of the many policy areas in which the EU governs, if agreement among existing and new Member States is to be reached, it will have to rely more upon the mutually beneficial nature of the particular decision, rather than upon the carrots and sticks that informed the accession process. Policy making in consumer safety, telecommunications markets, environmental protection and other policy areas will resemble a discrete set of collective action games that can only succeed if all the players strictly adhere to reciprocity norms.

The shift from strategies of power to strategies of cooperation will not necessarily be easy. Sociological studies have shown that patterns of behaviour learned in strongly hierarchical communities can be difficult to change. Thus, even though social and political relations can become more egalitarian, citizens following old habits of distrust may face difficulties engaging in collective governance. Robert Putnam's discussion of Italian regional government is instructive on this point.[77] Before unification in 1865, southern

[73] Act of Accession, Art 38.
[74] See MA Vachudova, 'The Trump Card of Domestic Politics: Bargaining Over EU Enlargement' (2001) 10 *East European Constitutional Review* 93.
[75] See RO Keohane and JS Nye, *Power and Interdependence* (Boston, Little Brown, 1977); A Moravcsik and MA Vachudova, 'National Interests, State Power, and EU Enlargement' (2003) 17 *East European Politics and Societies* 42.
[76] *Ibid* at 48.
[77] See RD Putnam, *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton, Princeton University Press, 1993).

Italy had been under the Bourbons for centuries, with feudal dependence and domination characterising most social and political relations. By contrast, many parts of northern Italy had been governed as independent city-states, run by oligarchies of powerful merchants and nobility. Even though they fell far short of modern definitions of democracy, they were more egalitarian and participatory in nature than the Bourbon kingdom to the south. According to Putnam, this difference continues to the present day and explains the difference in performance of local government. In the South, kinship, clan and patronage are the operative social networks, whereas the North is rich in civic associationalism, in the form of mutual aid societies, bird-watching societies, trade unions, and so on. In Putnam's account, kinship and patronage networks undermine democratic government precisely because of the distrust they foster. Patronage relations are a particular form of exchange relation — the powerful gives a job to the powerless in return, say, for a vote — but they do not build the social capital necessary for democratic governance. This is because the powerless party, knowing the significant risk that the powerful party will abuse her power, protects herself accordingly, through guile and other devices. One party has significant incentives to exploit, and the other party to shirk. In stark contrast, civic associationalism supports democratic governance because it requires cooperation in achieving collective goals among true equals.

This account of the failure of local democracy in southern Italy serves as a cautionary tale for Europe. The power relations that characterised enlargement were not conducive to learning the norms of reciprocity or to developing the trust that will be critical in the post-enlargement era. Indeed, there is every reason to believe that power was abused on occasion during the accession process, with all of the unfortunate consequences for the socialisation of old and new regulators.[78] Some candidate countries complain that Member States unfairly suspended trade or illegitimately blocked market liberalisation under the Europe Agreements.[79] While the Europe Agreements were intended to gradually remove trade barriers, both tariff and non-tariff, so as to establish a single market in certain areas before full EU membership, in some instances Member States invoked safety concerns

[78] As Elinor Ostrom conceptualises the problem, a player enters a prisoner's dilemma game already subscribing to a particular norm of reciprocity — which might be a norm against reciprocity — based on previous experiences. If, in the past, a player was never rewarded for cooperation with cooperation, or a player was never punished for defection with defection, then she is likely to subscribe to a weak norm of reciprocity and it will be more difficult to achieve cooperation in strategic game situations. E Ostrom, 'Toward a Behavioral Theory Linking Trust, Reciprocity, and Reputation' in E Ostrom and J Walker (eds), *Trust & Reciprocity* (New York, Russell Sage Foundation, 2003) 49-54. This type of experience, by definition, is more likely where there is an imbalance of power.

[79] See MA Vachudova, *Europe Undivided: Democracy, Leverage and Integration After 1989* (Oxford, Oxford University Press, 2004) (describing trade disputes over steel and livestock).

as a pretext for keeping their markets closed to Central and Eastern European goods, in what for trade lawyers amounts to a 'disguised restriction on trade.' There has likewise been grumbling about certain heavy-handed behaviour of Commission officials and Western experts in monitoring implementation of the *acquis*.

Consequences of Regulatory Defection for Post-Enlargement Europe

As argued earlier in this chapter, cooperative regulatory relations are critical to virtually every area of European administration. Without cooperation among national officials in developing and applying European norms, the free trade and policy guarantees contained in the Treaty and harmonisation directives would have little force. Yet a lack of confidence in the ability of new regulators to implement European law, together with habits developed during the enlargement process, could make both old and new regulators too ready to defect in their regulatory exchanges. Civil servants in existing Member States may too readily deny access to their markets on health and safety grounds and, in so doing, invoke the safeguard clauses in the Accession Treaty. New regulators, no longer constrained by the fear of being excluded from the common market, and influenced by their experiences under the Europe Agreements, may too readily perceive safeguards as illegitimate protectionism rather than legitimate public policy, and respond with their own form of defection. So, for instance, even though the new safeguard clauses are unavailable to new regulators as a means of blocking imports from existing Member States, new regulators could very well use administrative practices such as the discriminatory application of licensing standards or selective enforcement procedures to achieve much the same result. If this were to happen, regulatory relations could very quickly deteriorate, as game theorists have shown, into a defect-defect equilibrium, in which the benefits of a common market are not realised by either new or existing Member States. Yet, moving the game to a cooperate-cooperate equilibrium could be extremely difficult because it would require one regulator, in the face of retaliation and defection, to take a leap of faith and cooperate, perhaps not one time but many times. In other words, even though there might be high-level commitment among European governments to enlargement, success in each of the hundreds of common market areas depends on whether regulators are able to establish cooperative relations in the immediate aftermath of enlargement. Too many defections at the outset could compromise the establishment of the common market for years to come.

Let me cite enforcement of the Television Without Frontiers Directive to illustrate the dangers of regulatory defection. Among the current Member States, Germany is the best known for restricting racist hate speech to protect the personal dignity right guaranteed under Article One of the German Basic Law. Under the Directive, if Germany believes that another Member

State has failed to guarantee that broadcasting transmitted from its territory is free of hate speech, it may block broadcasts from that Member State.[80] Suppose a nationalist government takes power in one of the new Member States and the German broadcasting authorities doubt that its broadcasting authority will clamp down on neo-Nazi programming. They then see that a television documentary on the Holocaust from that country is being shown in Germany. According to the German authorities, it contains incorrect figures on concentration camps and an interview with David Irving, a notorious Holocaust denier. Therefore, even though the documentary also provides footage on concentration camps and interviews with Holocaust survivors, they decide to ban it. The question then becomes, was this an instance of defection, in which the German authorities simply assumed that the authority in the new members state would fail to clamp down on pro-Nazi programming, and denied that country the benefits of trade in broadcasting services, or was it an honest disagreement on the value of the documentary, in which case it was cooperation? If the broadcasting authority in the new Member State believes it to be defection, that state might retaliate by banning German television programmes on similarly plausible, but untrue, policy grounds. The same downward spiral could occur in any number of areas.

Solutions to the Risk of Defection in Common Market Regulatory Exchanges

Self-Awareness of the Structure of the Game

There are a number of possible antidotes to the risk of European regulatory relations degenerating into a defect-defect equilibrium after enlargement. First is self-awareness in both old and new Member States that an enlarged Europe can only be governed through mutually beneficial exchange among equals rather than through power dynamics. Even after May 2004, the old Member States will be able to exercise leverage over Central and Eastern European elites because they will still be dependent upon the EU for aid,[81] because access to the common market will be granted only in stages,[82] and

[80] Above, n 32, Directive 97/36, Art 2a.

[81] At the conclusion of the accession negotiations in December 2002, the Commission calculated that, in the first three years after enlargement, the net gain to future Member States would be EUR 13.66 billion (the difference between credits received from the Community budget in CAP funds, structural funds, and other programs and Central and Eastern European countries' contributions to the Community budget). *Agence Europe*, no 8363 (16 & 17 December 2002) 14.

[82] This is not unique to the Central and Eastern European accessions. Free movement of workers between Greece, Spain, and Portugal and the rest of the European Community only came into effect a full 10 years after they first joined.

because their right to participate in the Schengen area and monetary union remains to be decided. Eventually, however, if enlargement goes as planned, the accession states will participate in European governance on the same footing as all other countries, at which point reciprocity will be the only way to administer the common market. Regulators in current Member States, therefore, should quickly get into the habit of acting as if they are playing collective action games — games in which reciprocity and trust are vital for the success of the enterprise. Central and Eastern European regulators should also get into the habit of trust, and not let their pre-enlargement experiences colour their dealings within administrative networks post-enlargement.

Monitoring and Sanctioning

Second, the traditional role of the Commission and the courts as honest brokers in detecting defection and sanctioning breaches will be especially important in the first years after accession. It is critical that the institutions which do the monitoring and sanctioning be perceived as independent and impartial. The Commission is charged with reviewing and approving national safeguard measures, whether authorised by specific safeguard clauses, such as the one found in the Television Without Frontiers Directive, or by the general safeguard clauses found in the Accession Treaty. Yet immediately after accession, when the composition of Commission's civil service will still be heavily weighted toward the old Member States, the guardian will itself need a guardian. Even the Commission might be perceived by enlargement countries as partial, and hence it will be important to ensure that all of its decisions in safeguard cases are subject to judicial review. As might be recalled, in *Eurotica Rendez-Vous Television*, the Court of First Instance found that it did not have jurisdiction to review the Commission's finding in which the Commission allowed the British ban of foreign programming to stand. This meant that the Danish broadcaster could not contest the Commission's finding in the European court system.[83] Given that it is absolutely critical that the decision to block trade with a new Member State be perceived as fair, economic actors should be allowed to challenge Commission decisions in the Court of First Instance, when these

[83] Depending on local law on the reviewability of non-binding administrative acts, the Danish broadcaster might have been able to object to the Commission's decision in the UK judicial proceeding. The objection, however, would almost certainly have faced the same fate as the challenge to the UK Order. On that claim, the High Court ruled against the broadcaster on the substance (proportionality and discrimination) and refused to refer the question to the Court of Justice on the ground that Community law was clear. See *R v Secretary of State for Culture, Media and Sport ex parte Danish Satellite Television A/S and Rendez-Vous Television International SA* [1999] EWHC Admin 132 (12 February 1999), aff'd [1999] 3 CMLR 919 (Court of Appeal, Civil Division).

decisions directly enable the existing Member States to adopt trade-restrictive measures.

To monitor and sanction defection in Europe's system of repeated regulatory exchanges, the Commission and the courts also need good information. When old regulators invoke the safeguard clauses against goods and services from enlargement countries, the honest brokers will need to know whether new regulators broke their promise to administer the *acquis* or whether the old regulators' suspicions were stereotyped and unfounded. Did the new regulator defect by failing to enforce a European standard or did the old regulator defect by hindering free trade? One solution to this problem is the use of rebuttable presumptions to induce national authorities to come forward with information on their administrative decision-making, when that information is difficult for other regulators and the Commission to gather independently.

In the American usage, a rebuttable presumption places the burden of production and the burden of persuasion on one of the parties to the litigation. That is, the court will presume certain adverse facts against a party, unless the party produces evidence to the contrary and persuades the court that the evidence on balance does not support the court's adverse presumption. Although the European Court of Justice does not employ the language of rebuttable presumptions, burdens of production, or burdens of persuasion, it relies on similar devices in its jurisprudence. One might say that the single market is built on the rebuttable presumption that goods and services which circulate in one Member State are safe for circulation everywhere. That is, once the Commission or a litigant shows that a measure hinders trade and hence is covered by Article 28, the Member State must come forward with evidence and arguments showing that there is a legitimate public purpose for imposing the regulatory burden under Article 30 or the jurisprudence on mandatory requirements. The same rebuttable presumption applies when the Commission acts as the honest broker. National administrators are required to report trade-restrictive measures and, once they do so, they must also prove that the measure is justified on legitimate public policy grounds.

Clearly, the decision to place the burden on the country maintaining the public health or safety restriction is related to a belief that the presumption most accurately approximates the state of affairs, on the ground, in the Member States. The Court's famous *Cassis de Dijon* decision, which prompted the mutual recognition approach to harmonisation, stands for the proposition that most national regulatory measures hinder intra-European trade without any compensating welfare-enhancing effect.[84] In the Court's

[84] Case 120/78 *Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649.

analysis, if one Member State believes certain products and services to be safe, then the presumption is that they are safe for consumption everywhere. To some extent, this is based on assumptions as to the protectionist motives of national legislators. More importantly, in *Cassis de Dijon*, the Court recognised that many of the national regulations at issue were adopted at a time when governments and markets were still purely local and therefore the welfare-enhancing potential of trade and the interest of foreign traders were never even considered in the law making process.

Although rebuttable presumptions are often selected on the basis of their shorthand function, they can also be used to elicit information where there is good reason to believe that one party has better access to the relevant evidence than the other.[85] At this juncture in the common market, the Commission and the Court would do well to move away from the first rationale for presumptions and toward the second one. The question should not be 'are products which circulate in Europe generally safe or unsafe' but 'which party has the best information on the safety of the product?' Since the Single European Act, the assumption that regulatory measures are imposed for protectionist rather than safety reasons has less currency. National administrators have negotiated over two hundred harmonisation measures in which they have relinquished authority and shown a willingness to define common standards that accommodate both free movement principles and public interest concerns. At the same time, enlargement brings a real need for information on enforcement of regulatory standards. Existing regulators have legitimate reasons to distrust the ability of new regulators to administer the *acquis*. On questions such as whether a Ministry of Agriculture has conducted the appropriate number of veterinary spot checks, or has brought criminal prosecutions against farmers who fail to report suspicious cow deaths, that administration has the best information. Therefore, should a national agriculture regulator ban the import of cattle and adduce some evidence of dangerousness, the presumption in the Commission or the Court should be that the ban is legitimate. The burden would then be on the exporting administration to come forward with the information showing that it took all of the necessary precautions.

In regulatory exchange relations involving enforcement, the question of whether promises have been kept and cooperation has been practiced, is buried in the everyday activity of a foreign administration. A rebuttable presumption against the party claimed to have infringed a consumer safety, environmental protection, or public health standard might shed light on national administrative practices which are largely invisible to outsiders.

[85] RJ Allen, 'Presumptions in Civil Action Reconsidered' (1981) 66 *Iowa Law Review* 843, 854. See also I Ayres and R Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 *Yale Law Journal* 87, 97.

Especially given old regulators' unfamiliarity with the relevant Central and Eastern European regulatory systems, the information on health and safety practices which would be revealed in this manner could assist with regulatory cooperation.

Reciprocity

The last insight that the collective action approach can bring to enlargement is the prescription in favour of only one 'tit', not two, for every 'tat'.[86] If a Member State defects, other Member States, on their own accord, and the Commission and Court of Justice, in policing them, should respond only with defection in kind. Punitive, as opposed to purely reciprocal, defection will produce a rapid deterioration of the collective action game, inducing further defection, rather than cooperation in the next round.

In law making and rule making, tempering retaliation is a matter for national regulators and the Commission. Imagine, for instance, that the 25 are negotiating a directive on the liberalisation of local public transport and a Member State fails fully to disclose information on local conditions or to make concessions. The 'tit' for the 'tat' of failing to bargain in good faith might be the voting to override the country's interest in maintaining a form of transport which accommodates legitimate local needs, but also makes it more difficult for non-national service providers to compete. Tempering retaliation is also a recipe for the Commission, which mediates among Member States in proposing and re-proposing legislation and rules, and rewarding or punishing countries in successive versions of the proposals. Whether the decision to ignore the local need is punitive or proportionate can only be discerned by those deeply familiar with the policy issues, the interests of the different countries, and the bargaining history of the measure or set of measures.

In the realm of enforcement, the Court of Justice and national courts also become involved. Suppose an existing Member State invokes an Accession Treaty's safeguard clause in the belief that livestock from a Central or Eastern European state are unhealthy. Suppose further that the Commission reviews the evidence and finds, using the presumption that I recommended above, that the new regulator has not proven the livestock to be healthy. Information on defection or cooperation has been gathered, and there is agreement that defection has occurred. The question then becomes what type of response is warranted. The reciprocity or 'tit-for-tat' principle

[86] Given that it is difficult to quantify 'tits' and 'tats' in the world of European governance, this approximates Robert Axelrod's advice that the best strategy 'might be to return only nine-tenths of a tit for a tat.' R Axelrod and RO Keohane, 'Achieving Cooperation under Anarchy: Strategies and Institutions' in K Oye (ed), *Cooperation under Anarchy* (Princeton, Princeton University Press, 1986).

would suggest banning trade only in the particular item or service which is dangerous and only for as long as it is dangerous. One enforcement lapse, without further evidence, should not constitute grounds for suspecting enforcement lapses in other goods and services and blocking trade in those common market areas as well. Over-reaction can easily cause common market governance to degenerate into a defect-defect equilibrium, with bad faith health and safety arguments being advanced as pretexts for keeping out goods and services in competition with local producers.

The Court's case law from other accessions strongly suggests that the safeguard clauses in the Accession Treaty will be narrowly interpreted and that a strict reciprocity strategy among Member State regulators will be required. Because of the primacy of the four fundamental freedoms, the Court interprets derogations in accession treaties narrowly.[87] A whimsical moment from the Greek Advocate General captures the Court's approach. The case involved the interpretation of a derogation in the Finnish accession agreement in which certain goods were exempted from customs union tariff rates for a transitional period.[88] The Court, following the Advocate General, significantly narrowed the scope of the provision, finding that it applied only to goods imported into Finland directly from third countries and not to those same goods when imported into Finland via another Member State. In arguing for this approach, the Advocate General said:

> I believe, however, that the risk of deflection of traffic is ultimately to be considered as less serious than the risk of opening the bag of Aeolus and blowing uncheckedly off course the observance of a fundamental freedom — the free movement of goods — by broadly interpreting Article 99 of the Act of Accession, a provision which, because of its derogating nature, is to be interpreted narrowly. A wide interpretation could act as a Trojan horse, circumventing the fundamental principle of Community law of the free movement of goods, as enshrined in the Treaty.

This preoccupation with the free movement of goods and services in the enlarged common market will significantly limit old regulators' use of the safeguard clauses.

The Court also requires that trade-restrictive measures, such as bans imposed under the safeguard clauses, satisfy the principle of proportionality. Under proportionality, a national administrator's protective measure will not be permitted to inhibit trade with the enlargement country any

[87] See, eg, Case 231/78 *Commission v United Kingdom* [1979] ECR 1447, para 16, Case 77/82 *Peskeloglou v Bundesanstalt fur Arbeit* [1983] ECR 1085, para 12, Case 58/83 *Commission v Greece* [1984] ECR 2027, para 9, Case 11/82 *Piraiki-Patraiki v Commission* [1985] ECR 207, para 26.
[88] Case C-233/97 *KappAhl Oy* [1998] ECR 8069.

more than is strictly necessary for protecting the enacting state's legitimate public health or safety objective. Where the exchange among regulators can be framed as access to markets in return for protection of common health or other public interest standards, proportionality essentially amounts to the reciprocity principle. Therefore at least in those areas where the Court is institutionally capable of policing, national regulators will most likely be held to a strategy of reciprocity, thus keeping the risk of punitive, and ultimately self-destructive retaliation, low.

Possible Evolution of European Administration

Ultimately, the difficulties of cooperative regulatory relations in a Europe of 25 might be so great that, in certain policy areas, the Member States will take the unprecedented step of relinquishing their enforcement authority to a single European administration. To return to the contract analysis in the beginning of the chapter this would be the equivalent of internalising certain transactions within a single firm rather than relying on contractual relationships with multiple firms. In certain policy areas, defection might impose such high costs that credible commitments, credible threats, reciprocity, and trust simply will not suffice. Even if the players establish a cooperate-cooperate equilibrium, the risk of defection is never completely eliminated and may be too great for the players to bear. In other policy areas, the temptation to defect might be so great that a cooperate-cooperate equilibrium is always precarious. In such instances, the authority which currently resides in 15 separate bureaucracies can be expected to migrate — albeit in the face of great resistance — to a single European organisation. National regulators will be willing to relinquish their own enforcement authority in return for greater control over enforcement elsewhere.

To a limited extent, administrative centralisation has already occurred in the fields of monetary policy and food safety. The European Central Bank and, now, the European Food Safety Authority have been given the resources and the permanent staff necessary to develop their own technical expertise. They are not therefore as heavily reliant on self-reporting and national expert opinions as are the Commission services and agencies like the European Medicinal Evaluation Agency and the European Environmental Agency. The particular character of defection in these issue areas explains the institutional choice. In the food safety area, as the BSE crisis demonstrated, the costs of regulatory failure in one country can be overwhelming for other countries due to the political saliency of the problem and the ease with which the regulatory problem circulates. In monetary policy, likewise, there are significant externalities attached to the use of figures on national economic performance to influence interest rates and the use of inflationary fiscal policies to influence money supply.

With the increased difficulty of cooperative regulatory relations following enlargement, one can expect even greater centralisation in food safety and monetary policy as well as in other areas, such as pharmaceutical regulation. For instance, in food safety, the Member States might decide to establish European veterinary inspection offices in each of the Member States, staffed with civil servants chosen and trained in Brussels and financed through the European budget. By contrast, areas like customs and the distribution of agricultural and regional development subsidies can be expected to continue operating through coordination among independent regulators. The consequences of, say, a customs officer misclassifying a product for purposes of assessing duties or a local administrator taking bribes in the distribution of subsidies are very different from those of a health ministry official approving a new drug application without adequately assessing its side effects.

CONCLUSION

Debates on the institutional reforms necessary in anticipation of enlargement have focused largely on the problem of gridlock. How will European institutions decide anything with 25 members when it is already difficult with 15? Much attention has been devoted to the allocation of votes among small and large countries and to the dynamics of qualified majority voting. Voting rules are undoubtedly important, but they are not enough, since no matter how many harmonisation directives are passed in Brussels, without a series of cooperative relations among national administrators, a single market will not exist. Establishing such cooperative relations is a far more daunting task than negotiating one-time changes to the European institutional apparatus. By bringing to light the anarchic world that European regulators inhabit, I mean not only to emphasise the magnitude of the problem, but also to suggest the strategies and institutional mechanisms which can foster cooperative regulatory relations among new and old Member States. Sometime in the distant future, they might also serve as the foundation for the less concrete, yet in some respects more powerful, quality of trust.

References

Allen, RJ (1981) 'Presumptions in Civil Action Reconsidered' 66 *Iowa Law Review* 843.

Alter, KJ (2001) *Establishing the Supremacy of European Law: The Making of an International Rule of Law in Europe* (Oxford, Oxford University Press).

Axelrod, R and Keohane, R (1986) 'Achieving Cooperation under Anarchy: Strategies and Institutions' in K Oye (ed), *Cooperation under Anarchy* (Princeton, Princeton University Press).

Ayres, I and Gertner, R (1989) 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' 99 *Yale Law Journal* 87.

Bacharach, M and Gambetta, D (2001) 'Trust in Signs' in K Cook (ed), *Trust in Society* (New York, Russell Sage Foundation).

Burley, A-M (1992) 'Law Among Liberal States: Liberal Internationalism and the Act of State Doctrine' 92 *Columbia Law Review* 1907.

Caporaso, JA and Stone Sweet, A (2001) 'Institutional Logics of European Integration' in A Stone Sweet et al (eds), *The Institutionalization of Europe* (Oxford, Oxford University Press).

Cassese, S (2003) *Lo spazio giuridico globale* (Bari, Gius. Laterza and Figli).

—— (2003) 'Il diritto amministrativo europee presenta caratteri originali?' 1 *Rivista trimestrale di diritto pubblico 35*.

Cecchetti, SG and O'Sullivan, R (2003) 'The European Central Bank and the Federal Reserve' 19 *Oxford Review of Economic Policy* 30.

Chiti, E (2003) 'Decentralized Integration as a New Model of Joint Exercise of Community Functions: A Legal Analysis of European Agencies' *European Public Law Review* (forthcoming, copy on file with author).

Cook, K and Hardin, R (2001) 'Norms of Cooperativeness and Networks of Trust' in M Hector and K-D Opp (eds), *Social Norms* (New York, Russell Sage Foundation).

de Búrca, G (2003) 'The Constitutional Challenge of New Governance in the European Union' 28 *European Law Journal* 814.

della Cananea, G (2003) 'I procedimenti composti dell'Union europea', paper presented at conference held at Università di Roma 'La Sapienza' 8 April 2003.

Everson, M (2002) 'The Crisis of Indeterminacy: An 'Equitable' Law of Deliberative European Administration?' in C Joerges and R Dehousse (eds), *Good Governance in an 'Integrated' Market* (Oxford, Oxford University Press).

Gambetta, D (1993) *The Sicilian Mafia: The Business of Private Protection* (Cambridge, Mass, Harvard University Press).

Haas, EB (1961) 'International Integration: The European and the Universal Process' 15 *International Organization* 366.

Halberstam, D (2001) 'Comparative Federalism and the Issue of Commandeering,' in K Nicolaidis and R Howse (eds), *The Federal Vision: Legitimacy and Levels of Governance in the US and the EU* (New York, Oxford University Press).

Helfer, LR and Slaughter A-M (1997) 'Toward a Theory of Effective Supranational Adjudication' 107 *Yale Law Journal* 273.

Joerges, C (2001) 'Law, Science and the Management of Risks to Health at the National, European and International Level — Stories on Baby Dummies, Mad Cows and Hormones in Beef' 7 *Columbia Journal of European Law* 1.

—— (2002) 'Deliberative Supranationalism — Two Defences' 8 *European Law Journal* 133.

Joerges, C and Neyer, J (1997) 'From Intergovernmental Bargaining to the Deliberative Political Process: The Constitutionalisation of Comitology' 3 *European Law Journal* 273.

Keohane, R (1984) *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton, Princeton University Press).

Keohane, R. and Nye, JS (1977) *Power and Interdependence* (Boston, Little Brown).

Koh, HH (1994) 'Transnational Legal Process' 75 *Nebraska Law Review* 181.
Levi, M (2000) 'When Good Defenses Make Good Neighbors' in C Menard (ed), *Institutions, Contracts, and Organizations: Perspectives from New Institutional Economics* (Colchester, UK, Edward Elgar).
Lindseth, P (2001) 'Delegation is Dead, Long Live Delegation: Managing the Democratic Disconnect' in C Joerges and R Dehousse (eds), *Good Governance in Europe's Integrated Market* (Oxford, Oxford University Press).
Majone, G (2000) 'The Credibility Crisis of Community Regulation' 38 *Journal of Common Market Studies* 273.
Majone, G and Everson, M (2001) 'Institutional reform: independent agencies oversight, coordination and procedural control' in O De Shutter, et al (eds), *Governance in the European Union* (Brussels, European Commission).
Monnet, J (1976) *Mémoirs* (Paris, Fayard).
Moravcsik, A (1989*) The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (Ithaca, Cornell University Press).
Moravcsik, A and Vachudova, MA (2003) 'National Interests, State Power, and EU Enlargement' 17 *East European Politics and Societies* 42.
Olson, M (1971) *The Logic of Collective Action* (New York, Schocken Books).
Ostrom, E (1990) *Governing the Commons: The Evolution of Institutions for Collective Action* (Cambridge, Cambridge University Press).
—— (2003) 'Toward a Behavioral Theory Linking Trust, Reciprocity, and Reputation' in E Ostrom and J Walker (eds), *Trust & Reciprocity* (New York, Russell Sage Foundation).
Oye, K (1986) 'Explaining Cooperation under Anarchy: Hypotheses and Strategies' in K Oye (ed), *Cooperation under Anarchy* (Princeton, Princeton University Press).
Pierson, P (1998) 'The Path to European Integration: A Historical-Institutionalist Analysis' in W Sandholtz and A Stone Sweet (eds), *European Integration and Supranational Governance* (Oxford, Oxford University Press).
Podolny, J and Page, KL (1998) 'Network Forms of Organization' 24 *Annual Review of Sociology* 57.
Pollack, MA (2003) *The Engines of European Integration: Delegation, Agency, and Agenda – Setting in the EU* (Oxford, Oxford University Press).
Putnam, RD (1993) *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton, Princeton University Press).
Rose-Ackerman, S (2001) 'Trust and Honesty in Post-Socialist Societies' 54 *Kyklos* 415.
—— (2001) 'Trust, Honesty and Corruption: Reflections on the State-Building Process' 42 *Archives of European Sociology*.
Sabel, C and Cohen, J (2003) 'Sovereignty and Solidarity in the EU,' in J Zeitlin and T Trubek (eds), *Work and Welfare in Europe and the US* (New York, Oxford University Press).
Sandholtz, W and Stone Sweet, A (1998) 'Integration, Supranational Governance, and the Institutionalization of the European Polity' in W Sandholtz and A Stone Sweet (eds*), European Integration and Supranational Governance* (Oxford, Oxford University Press).
Scharpf, F (2001) 'What Have We Learned? Problem-Solving Capacity of the Multilevel European Polity' *Max Planck Institute for the Study of Societies* (MPIfG Working Paper No 01 / 4 July 2001).

Scott, J and Trubek, D (2002) 'Mind the Gap: Law and New Approaches to Governance in the EU' (2002) 8 *European Law Journal* 1.
Shapiro, M and Stone Sweet, A (2002) *On Law, Politics & Judicialization* (Oxford, Oxford University Press).
Shavell, S (2004) *Foundations of the Economic Analysis of Law* (Cambridge, Mass, Harvard University Press).
Snidal, D (1986) 'The Game Theory of International Politics' in K Oye (ed), *Cooperation Under Anarchy* (Princeton, Princeton University Press).
Stone Sweet, A et al (2001) 'The Institutionalization of European Space' in A Stone Sweet et al (eds), *The Institutionalization of Europe* (Oxford, Oxford University Press).
Tallberg, J (2002) 'Paths to Compliance: Enforcement, Management, and the European Union' 56 *International Organization* 609.
Vachudova, MA (2001) 'The Leverage of Internationalizing Institutions on Democratizing States: Eastern Europe and the European Union' *Robert Schuman Centre for Advanced Studies* (Working Paper No 2001/33, Fiesole, European University Institute).
—— (2001) 'The Trump Card of Domestic Politics: Bargaining Over EU Enlargement' 10 *East European Constitutional Review* 93.
—— (2004) *Europe Undivided: Democracy, Leverage and Integration After 1989* (Oxford, Oxford University Press).
Van Miert, K (2000) *Le marché et le pouvoir* (Paris, Editions Racine).
Weiler, JHH (1991) 'The Transformation of Europe' 100 *Yale Law Journal* 2403.
Williamson, O (1985) *The Economic Institutions of Capitalism* (New York, The Free Press).
—— (2000) 'The New Institutional Economics: Taking Stock, Looking Ahead' *38 Journal of Economic Literature* 595.

5

The Legal Foundations of the Enlarged European Union

A COMMENT BY GEORGE A BERMANN
AND GRÁINNE DE BÚRCA

VIEWED COLLECTIVELY, THE chapters in this Part of the Book, entitled 'The Legal Foundations of the Enlarged European Union,' remind us that the term 'legal foundations' covers a wide range of understandings. Clearly, the particular aspect or dimension of those foundations on which one chooses to focus — and each chapter in this Part makes a choice in that respect — determines the nature of the enlargement story to be told.

Before turning to the particularities that each chapter addresses, we need to underscore certain commonalities. First, each contribution acknowledges that the most interesting and fundamental questions associated with enlargement have nothing to do with 'numbers,' whether in the membership of the European Parliament, or in the qualified majority voting formula in the Council, or in the composition of the Commission. This is not to say that the 'numbers' issues may not in turn reveal problems that are, themselves, quite fundamental.

Moreover, the contributions all demonstrate, albeit to differing extents, that while the contemporaneous occurrence of enlargement and the recently concluded Constitutional Convention is by no means coincidental, their relationship is far from a simple or uni-directional one. Thus, although current debates over the constitutional treaty appear to be part of the enlargement picture (and vice versa), the prospects of enlargement are not claimed to have triggered the constitutional convention, nor is the Convention described as essential to the realisation of this enlargement or future enlargements. Indeed, it was believed by many at the time, including the accession states themselves, that the 2000 IGC culminating in the Treaty of Nice had made (however contentiously) the basic institutional changes that were required to facilitate the next enlargement.[1] At the same time, however, the

[1] See eg B Plechanovová, 'The Treaty of Nice and the Distribution of Votes in the Council — Voting Power Consequences for the EU after the Oncoming Enlargement' *European*

prospect of enlargement has certainly rendered more urgent many of the tasks and institutional questions faced by the Convention, and in some cases has added new dimensions to existing dilemmas and challenges.

Each of the four chapters in this Part deals directly or indirectly with the potential impact and relevance of enlargement for certain aspects of the legal and constitutional foundations of the EU. And in a sense, each focuses — at least in part — on a different chronological stage of the enlargement process. At the beginning of his chapter, Joseph Weiler questions the way in which the original decision to enlarge the EU eastwards was taken. This was a profoundly constitutional question of deep political and symbolic significance, as to which there was little or no public debate, no lengthy discussions and deliberations, and no Convention process to consider the pros and cons of such a fundamental decision from the viewpoint of the EU's future. Wojciech Sadurski's contribution highlights a subsequent stage insofar as he considers the extent to which the accession states were involved in the drafting of the rules and foundational principles on which the 'renewed' constitutional polity stood to be based.

Ingolf Pernice's chapter dwells most squarely on the familiar institutional issues raised by the prospect of enlargement, namely how the institutional and decision making structure of the EU should be reformed, and in particular how it should be adapted to cope with the size and scale of the enlargement. In that sense, his chapter moves beyond the pre-accession phase to consider the appropriate institutional arrangements, post-enlargement. Finally, Francesca Bignami's chapter considers how the governance and administration of the EU in practice is likely to be affected once the new members are admitted, focusing on the problems of lack of familiarity and trust, problems which cannot so easily be resolved by formal rules and decisions.

But the differences among the chapters relate not only, or even most importantly, to the chronology of enlargement. Each isolates a particular problem, or series of problems, whose solution will tend to define, or redefine, the legal foundations of the Union.

For Ingolf Pernice, enlargement demands that we re-examine the EU's 'grand' institutional architecture, an architecture whose component parts have retained the same fundamental character they have had since 1957. Enlargement further demands that we confront this architecture's less than satisfactory aspects. Whether or not one accepts Pernice's prescription — *viz* a single Presidency of the European Council and the Commission (hence a single Presidency of the Union), whose occupant would be designated by the European Parliament after the fashion of a traditional parliamentary system (and the Convention has in fact rejected it) — the fact remains that

the governance values at stake in the debate over the EU's architectural design were long ago identified and acknowledged as important. Those values are basically: (a) an enhanced democratic accountability of the European Commission, (b) enhanced efficiency and continuity in the workings of the Council of Ministers and the European Council, and (c) a more coherent personification of Europe on the international stage (the 'one-voice-in-foreign-affairs' idea). Thus, the constitutional urgency that is felt today flows less from the specific exigencies of enlargement than from the sheer importance and durability of these underlying concerns. It is accordingly difficult to imagine that any constitutional redesign — whether Pernice's or the Convention's — that responds adequately to these concerns will not also enable the European Union to cope with the present and prospective enlargements.

It is of course true that an expansion of the EU to include up to 27 members will require, if the Union is to continue to function effectively, reform of a more radical kind than has been contemplated or proposed in the past, in particular as far as the size of the Commission and the nature and scope of qualified majority voting are concerned. The ready acceptance within the Convention and its working groups of the principle of legal personality of the Union, after years of resistance to such a move, indicates that at least some previously thorny issues have been resolved without much contention.[2] However, the much fiercer debate within the Convention over proposals to reduce significantly the size of the Commission, and to have a more permanent president of the Council, rather than a strengthened Commission president or a combined presidency, suggests that many of the other perennially controversial institutional questions on which Pernice's chapter concentrates may be rather more difficult to resolve within a firm constitutional settlement. Further, while the reforms on which he focuses are clearly designed to make the EU stronger, better defined in institutional terms, and more effective in its decision making, these aims do not necessarily coincide with making the EU a more genuinely democratic polity, nor would they necessarily reduce the degree of alienation and distance that many Europeans feel from this polity. The centralisation of institutional strength and the vast increase in the size of the population, post-enlargement, which is to be served by a European Parliament whose membership size does not increase, are not in themselves likely to bring the citizen closer to the EU.

Unquestionably central though these grand institutional issues may be, it would still be a mistake to suppose that the legal foundations of an enlarged European Union are confined or reducible to the 'canonical' institutions (the Parliament, Council and Commission) that have defined the Union's traditionally-conceived triangular architecture. The EU's densely

[2] See Art I-6 of 'Draft Treaty establishing a Constitution for Europe' *The European Convention* (Brussels, 20 June 2003) CONV 820/03.

constructed governance scheme consists equally of other, less institutionally prominent actors: national and sub-national regulators, members of 'comitology' committees and working groups, advisory groups, agencies, and civil society generally. Francesca Bignami's contribution demonstrates that, even more than relations between and among the three 'main' institutions, relations among these other actors depend crucially on the quality of their interactions and on the 'games' on which those interactions are built. These games play out best when they generate trust. They play out worst when, far from generating trust, they erode whatever trust that exists, possibly triggering a downward spiral in cooperation among participants.

Once we recognise that this range of actors and interactions, while less often exposed to the public or to the political spotlight, also forms part of the EU's legal foundations, we can no longer assert as confidently as we otherwise might that keeping the European Union enterprise afloat is essentially the same with as without enlargement. More particularly, to the extent that the EU is a fundamentally 'trust-based enterprise,' as Bignami underscores, enlargement clearly matters, and in fact matters a great deal. Viewing the Union's legal foundations in this light, we may legitimately ask whether the substratum of trust among national and sub-national regulators which was gradually built up over years of engagement, and which largely prevailed pre-enlargement, will as readily endure post-enlargement. Put more pointedly, will the specific 'safety valves' that Bignami identifies as having served the Union well up to now in managing relations among the actors continue adequately to serve that function under the circumstances of a very sizeable enlargement?

Among these instruments, Bignami singles out in particular a new species of safeguard clauses. Unlike their traditional counterparts, which permitted states (subject of course to procedural requirements and Commission review) to protect essential state interests in derogation from agreed upon rules, the new safeguard clauses may be described less as self-protective in nature than as retaliatory and even punitive. To the extent that safeguard instruments possess a recriminatory flavour, they pose an evident risk to the fabric of trust upon which the political dynamics described by Bignami depend. We must reckon with the possibility that, in order to contain the potential unravelling of relations, we shall have to fall back on the very overworked 'institutions' — and in particular the Commission and the Court of Justice — that have traditionally provided the political and legal mediation, respectively, in such circumstances.

The challenge then, it would seem, is not only to identify with some precision the risks that enlargement poses to the intensely informal system of 'gaming' that Bignami describes, but to respond to them more resourcefully — both proactively and prophylactically — than we ordinarily do in confronting diffuse and decentralised dynamics of this sort. The difficulty is heightened, of course, by the fact that, while the kind of prescription that

Ingolf Pernice has advanced in response to the institutional challenges of enlargement may be implemented through a Convention for the drafting of a constitutional treaty, and hopefully through the constitutional changes that ensue, the contribution that the Convention may make to the kind of challenges that Bignami describes is much less obvious. Further, problems of trust and adaptation may well be exacerbated by the accession states' experience of an unprecedentedly long and demanding pre-accession phase during which they were required to absorb the vast bulk of the *acquis communautaire*, and yet were treated in a way that is very different from the treatment one would accord to states that are considered as equal partners in an integration enterprise. As against this, however, the fact that officials from the accession countries were also involved during the pre-accession period in some of the meetings of regulators and administrators from the existing Member States suggests that the process of mutual acclimatisation and trust-building may already have had a chance to develop.

One instrument having particular resonance for the question of trust and distrust in the fabric of relations among EU actors is of course the Charter of Fundamental Rights. As suggested by Wojciech Sadurski, no Convention agenda item — neither the question of competences, nor the single presidency, nor the pillar structure, nor the qualified majority voting formula — can be expected to affect the relations of trust and distrust as profoundly as the Charter has the potential to do; none has quite the Charter's aspirational and inspirational character, and thus the potential for broad political community-building. To borrow Joseph Weiler's term, the Charter represents important 'iconography,' counterbalancing the euro, which is likewise immensely symbolic, but which emits quite different vibrations. While enlargement's prospect may have fuelled the impetus for such a Charter (and we believe it did), the converse is also true: having a Charter of Rights may help — despite the evident reluctance of certain Member States, and the UK in particular, to give it teeth — to establish the sense of solidarity and commonness of purpose upon which the success of enlargement itself depends.

More specifically, Sadurski claims that the process of constitution drafting — and in particular its focus on rights — might actually help to counter the so-called 'sovereignty conundrum' faced by many of the Central and Eastern European states. The popular and political concerns over ceding national sovereignty, recently regained from a hegemon to the East, to a new hegemon in the shape of the EU to the west, may be countered, in Sadurski's view, by the emphasis on fundamental rights in the new European constitutional settlement.[3] This emphasis could also, he suggests,

[3] His argument in this respect partly echoes the earlier work of Andrew Moravcsik, who studied the attitudes of states to the earlier European Convention on Human Rights, and argued

reassure the accession states importantly about unity and parity amongst EU Member States, guarding in part against a Europe of different speeds. Finally, the enshrinement of certain human rights standards in the Charter might be seen by the accession states as a welcome stabilisation of certain aspects of the hitherto moving target to which they had been required to conform. This perspective contrasts with that of Joseph Weiler who, being less focused on the enlargement issue per se, sees adoption of the Charter as a rather less welcome crystallisation of norms which is hedged about by problematic phrases such as 'in accordance with national laws and practices', and is not underpinned by the real EU policy reforms that are needed.[4] This issue will be returned to further below.

This is not to say that the Charter is unique in its capacity to promote the solidarity and commonness of purpose crucial to successful enlargement. Two other instruments come to mind in this regard, one traditional, one less so. First, a consciousness of the economic benefits of market integration gave the EU handsome political impetus in the period leading up to and following the Single European Act and the greater cohesion that it helped produce. We doubt that this consciousness has fully run its course in this regard, as may be indicated by the Commission's newly launched strategy for the internal market 2003–2006,[5] in which the imminence of enlargement is cited as one of the key reasons why the EU 'needs to make a determined push' to improve and enhance market integration. But new energising instruments are also likely to emerge; pre-eminent among them, in the wake of the war in Iraq, is the development of institutions permitting a more coherent and forceful voice for the Union in world affairs. Indeed, the emerging consensus on the need for an EU foreign minister, combining the functions of the current Commissioner for external relations with the High Representative for the common foreign and security policy, suggests a move in this direction.[6] Whether such institutional reforms can overcome the political divisions and policy differences which have hitherto prevented the emergence of a common European foreign policy remains to be seen.

Joseph Weiler's contribution forms a kind of bookend to the present analysis. While raising a series of issues of the same order of institutional magnitude

that new and less-established democracies were more likely to strongly favor mandatory and enforceable human rights obligations than established and powerful democracies: see A Moravcsik, 'The Origins of Human Rights Regimes: Democratic Delegation in Post-war Europe' (2000) 54 *International Organization* 217.

[4] See his earlier argument in this vein: JHH Weiler, 'Does the European Union Truly Need a Charter of Rights?' (2000) 6 *European Law Journal* 95.
[5] Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions — Internal Market Strategy — Priorities 2003-2006 COM (2003) 238 final.
[6] Above, n 2, Arts I-20(2) and I-23(2).

as Ingolf Pernice, Weiler does not address — much less advocate — specific institutional rearrangements in response to them. Like Sadurski, he prefers to address the theme of the symbolic meaning of enlargement, challenging, albeit in a somewhat different way, the commonly held view that the projects of widening and deepening the EU stand in tension with one another. Still, Weiler's well-known views on the 'principle of constitutional tolerance' which has long underpinned the European legal and political bargain lead him to doubt the value of a formal project of constitution writing for the EU.

Accepting that the constitutional enterprise has been launched, Weiler turns to a series of questions about the Convention's basic assumptions. Apart from his views on the constitutional role of the Charter of Rights, discussed above, the problems that he considers are (a) the choice between a constitution, on the one hand, and a constitutional treaty, on the other, (b) the constitution's — or constitutional treaty's — value specificity, (c) the question of Union competences, and (d) 'constitutional amendability.' How, we may ask, does or should the current enlargement affect our responses to these issues?

In the first place, does enlargement serve to clarify the nature or consequences of the choice between a constitution and a constitutional treaty? One possible consequence of such a choice would be that a constitution normally permits amendment by less than unanimity among the participating states, while amendment of a constitutional treaty, at least presumptively, requires a full treaty-type ratification in accordance with international and domestic law. So understood, the move from a constitutional treaty to a constitution would have much greater significance in a post-enlargement, as compared to a pre-enlargement, Europe. Apart from the practical consequences, however, there are of course deeper symbolic differences between a constitutional treaty and a constitution, the latter requiring a level of political community and a degree of polity unity which transcends the 'international organisation of states' model which a treaty (even a constitutional treaty) implies. The linking of enlargement with the adoption of a true Constitution would thus appear to defy, or at least to challenge, the received wisdom that widening and deepening are alternative rather than complementary choices. Nevertheless, it seems likely that the political ground is not yet fertile for the adoption of a European Constitution proper, and that the 'via media' of a constitutional treaty will be chosen by the Member States and the future Member States alike during the post-Convention IGC as the legal foundation of an enlarged European Union.

Turning to the issue of value specificity, does such specificity provide enhanced constitutional support for enlargement, as indeed Sadurski's contribution suggests in relation to the Charter? Might enlargement actually require a constitutional commitment to certain values? Weiler is reluctant to see social solidarity enshrined as a specific value in the Constitution,

chiefly due to doubts about the strength of the current consensus surrounding that value, but also out of fear of removing social welfare debates from the realm of political and deliberative discourse by elevating them to constitutional rank. In this sense, his position is not so far from the preference of the UK representatives within the Convention for rendering non-justiciable the social rights and 'principles' under the Charter.[7] Yet it seems highly plausible that constitutionally enshrining values such as social solidarity or human rights could have substantial added value in this regard, particularly if, like Bignami, we attach a high degree of importance to the polity's fabric of trust. Similarly, Weiler would not render human rights a 'value-specific' constitutional dossier by making the move from simple Charter to full-fledged human rights policy, complete with a Commissioner, a Directorate-General and an action plan. But in our view, there may be real polity-building value in elevating human rights from essentially a condition of the validity of EU measures to a veritable EU policy.

There may be a certain tension, indeed, between Weiler's opposition to an EU constitutional commitment to a European welfare state and to the existence of EU competence in this regard, on the one hand, and his dislike of the clauses in the Charter which link the guarantees of protection for social rights to national laws and practices, on the other. Arguably, what such clauses seek to do is to mediate the tension between the desire to articulate a commitment to a European social model which takes seriously the importance of social and economic as well as civil and political rights, on the one hand, and the recognition, on the other, that, politically and financially speaking, these are still largely subject to the different policies pursued by the various Member States and are not a central part of Community competence. In other words, these clauses of the Charter might, if we construe them in a positive light, be seen as a mixture of the EU's normative commitment and its recognition of the primary competence of the Member States for the organisation and provision of national welfare. This combination is a feature typical of those policy areas in which the EU has begun to develop and use so-called 'new governance' modes, through which an attempt is made to set EU-level objectives and to coordinate and learn from divergent national policies in fields in which the EU is not primarily competent to act. It may be no coincidence that the group of independent experts on fundamental rights, which was established by the Commission in 2002 following a proposal by the European Parliament, proposed in its first report on fundamental rights within the EU to establish an open method of

[7] See Chairman of Working Group II on Incorporation of the Charter/ accession to the ECHR, 'Final Report of Working Group II' (Brussels, 22 October 2002) CONV 354/02, the recommendations of which have largely been followed in the text of the constitutional treaty presented to the Thessaloniki European Council of June 2003, see above, n 2, CONV 820/03, Part II.

coordination for the purposes of implementing the rights contained in the Charter.[8]

The issue that Weiler next addresses is whether and how enlargement might bear upon the 'competences' question. Weiler has long despaired of the competence question being resolved appropriately, if it is persistently approached in terms of a catalogue. He has elsewhere called instead for a constitutionally agreed upon policing mechanism, if necessary, a kind of French *Conseil Constitutionnel*, ie a permanent body carefully structured so as to exercise timely and responsible pre-promulgation competence review.[9] Enlargement arguably enhances the case for a policing mechanism of this sort. How can new Member States — indeed how can any Member State, new or old — hope to see the appropriate federalism balance within the Union preserved if the federalism question must continue to be asked as part and parcel of the political process? It seems likely that polities within the new Member States could more effectively influence the 'jurisdictional' determinations of this sort through representation in a jurisdiction-verifying body of this sort, and that the federalism balances thereby achieved might thereby gain legitimacy.

However, no such development has materialised, either as part of the constitutional process or as a consequence of enlargement. The main developments which have so far been suggested entail instead a new mechanism involving political review by national parliaments of the 'subsidiarity' question, but no significant increase in the jurisdiction of the European Court of Justice, and certainly no establishment of a new jurisdictional body.[10] In one minor but nonetheless interesting development, given the significance of the concerns of the German *Länder* in the European competences debate, it has been proposed that the Committee of the Regions should, alongside the Member States acting on behalf of their national parliaments, have the right to bring a case before the Court of Justice for violation of the subsidiarity principle by a legislative act, in circumstances where the Treaty has provided for a right of consultation on the adoption of the legislative act in question.[11] And while the principle of subsidiarity does not involve exactly the same issues as the question of competences, the two issues are nonetheless closely related, in particular since the principle of subsidiarity concerns the legitimacy of the exercise of EU competence in any given situation.

[8] EU Network of Independent Experts on Fundamental Rights (CFR-CDF) 'Report on the Situation of Fundamental Rights in the EU and its Member States in 2002' <http://foi.missouri.edu/terrorandcivillib/mainreport.pdf> (7 January 2004).

[9] See eg JHH Weiler, 'To be a European Citizen: Eros and Civilization' in *The Constitution of Europe* (Cambridge, Cambridge University Press, 1999) 353.

[10] See above, n 2, Art I-9 of the draft constitutional treaty, the Protocol on the Role of National Parliaments in the European Union, and the Protocol on the Application of the Principles of Subsidiarity and Proportionality, CONV 820/03.

[11] See Art 7 of the Protocol on the Application of the Principles of Subsidiarity and Proportionality, *ibid*.

When we turn finally to the matter of 'constitutional amendability,' enlargement moves potentially front and centre. If enlargement fundamentally alters constitutional dynamics in any respect, surely this is it. In an enlarged Europe which hopes to see its constitution (or constitutional treaty) endure, constitutional amendment must be achievable with something short of the unanimous consent of the Member States.[12] No less vital is the much-discussed possibility of constitutional exit. Both qualified majority amendability and exit are not without considerable political and constitutional risks, but they may prove indispensable to enlargement's constitutional workability. The current Convention draft contemplates the possibility of exit, but not the possibility of amendment by anything less than unanimity.

In sum, the EU leadership's willingness to reconsider basic EU architectural design may have been indispensable to its willingness to embark on the current enlargement. But enlargement has not made the process of redesign itself any the easier. As the chapters in this Part demonstrate, the EU's legal foundations are situated not only in grand institutions as such, but also in the informal processes and attitudes that shape the behaviour of a wide range of public and private sector actors. Finally, a constitutional treaty also reflects a series of choices regarding power allocation, constitutional process, and constitutional values. If enlargement has not fundamentally altered our assessment of the institutions of the European Union, it undoubtedly affects the landscape in which the informal processes and attitudes referred to play themselves out, and it properly influences the choices to be made about these issues of power allocation, constitutional process, and constitutional values.

References

de Witte, B (2003) 'Entry into Force and Revision' in B de Witte (ed), *Ten Reflections on the Constitutional Treaty* (Florence, Robert Schuman Centre).

Moravcsik, A (2000) 'The Origins of Human Rights Regimes: Democratic Delegation in Post-war Europe' 54 *International Organization* 217.

Plechanovová, B (2003) 'The Treaty of Nice and the Distribution of Votes in the Council — Voting Power Consequences for the EU after the Oncoming Enlargement' *European Integration online Papers* (vol 7 n 6).

[12] See, in this respect, the suggestions made by Bruno de Witte, 'Entry into Force and Revision' in B de Witte (ed), *Ten Reflections on the Constitutional Treaty* (2003) <http://www.iue.it/RSCAS/e-texts/200304-10RefConsTreaty.pdf> (18 December 2003).

Weiler, JHH (2000) 'Does the European Union Truly Need a Charter of Rights?' 6 *European Law Journal* 95.
—— (1999) 'To be a European Citizen: Eros and Civilization' in *The Constitution of Europe* (Cambridge, Cambridge University Press).

Part II

The Governance of Labour Relations

6

The Convergence of European Labour and Social Rights: Opening to the Open Method of Coordination

SILVANA SCIARRA

THE CURRENT DISCUSSION on labour and social law within the contest of institutional reform is stimulating and rich. Although the impact that the Convention on the Future of Europe[1] may have on labour and social rights is still unclear, the climate created around it is such to favour interesting research concerning methodology and substance.

Enlargement requires legal analysis based on a very broad basis that is open and free of prejudices. Convergence of European rights does not concur with the national traditions by mechanically merging into a fully consolidated system of norms. It is, rather, a continuous and fruitful discourse on how to share objectives and select relevant tools towards their implementation. Convergence, I argue in this chapter, should be thought of as the result of accurate legal comparison and include procedures, as well as rights within the spectrum of analysis. An overall notion of labour standards should be developed, reflecting the evolving *acquis* in the social field.

In order to approach such complex comparative research correctly, lawyers must be aware of differences between the legal systems they analyse. As the tradition of comparative legal scholarship in Europe has taught us, the attempt to pursue a 'transplant' of legal institutions uncritically[2] is both a sign of disregard for traditions different from the one to be transplanted, and, very often, is an inefficient solution.

[1] In order to pave the way to the next Intergovernmental Conference (IGC), the 'Convention on the Future of Europe' was convened in the European Council meeting held in Laeken, on 14 and 15 December 2001. See 'Convention on the Future of Europe' annexes to Presidency Conclusions, s III, 24.

[2] This is the traditional analysis developed by O Kahn-Freund, 'On uses and misuse of Comparative Law' (1974) 37 *Modern Law Review* 1; and in *Selected Writings* (London, Stevens, 1978).

The choice to pursue harmonisation appears similarly inefficient, at least when aiming at the convergence of legal standards. Further on I shall examine harmonisation among other regulatory techniques in the field of European labour law and consider whether the fact that it is currently playing only a marginal role when compared with other techniques is due to the growing complexity of the issues to be regulated.

In her contribution, Csilla Kollonay Lehoczky notes the widespread cautious attitude taken by public opinion in her country with regard to the implications of accession to the EU.[3] I want to maintain that the present stage of integration is a particularly rich and open one, especially in the field of social law and employment policies.

Several justifications can be offered for what might otherwise appear as an over optimistic point of view. First of all, opening up to civil society and improving participation in governance has been a practice as well as a target of European institutions, which has been strengthened and rationalised by the Commission's White Paper.[4] The 'culture of consultation and dialogue' pursued by the Commission relies on transparency and adequacy in approaching interested parties. It also aims at setting guidelines on the use of expertise and at making the consultation of regional and local associations a more systematic routine.[5] In the context of greater institutional attention paid to non-institutional actors — namely the social partners or other groups and organisations active for the protection of specific collective interests — the drafting of the EU Charter of Fundamental Rights constitutes an important precedent of how intergovernmental compromises can be attenuated and pave the way to a more open process of decision making.[6] This experiment has been continued and adapted in setting up the Convention on the Future of Europe.

The second justification is more closely related to employment policies and shows another positive sign of openness of the supranational legal system, which should be stimulating for the acceding countries. Title VIII of the current Treaty of the European Union (TEU) on social and employment

[3] See C Kollonay Lehoczky, ch 8. In 1994 Hungary was the first country applying to become a Member of the EU. Negotiations started in 1998 and one year later the Commission declared that Hungary met the criteria for accession.

[4] Commission of the European Communities, European Governance COM (2001) 428 final (25 July 2001) (White Paper).

[5] Communication from the Commission, 'Towards a reinforced culture of consultation and dialogue. Proposal for general principles and minimum standards for consultation of interested parties by the Commission' COM (2002) 277 final (Brussels, June 5 2002). See also the database for Consultation, the European Commission and Civil Society: <http://europa.eu.int/comm/civil_society/coneccs/index.htm> (9 January 2004).

[6] G De Búrca, 'The Drafting of the EU Charter of Fundamental Rights' (2001) *EL Rev* 126. The inclusion of the Charter in the Treaties, discussed in Working Group II of the Convention, raises a series of questions examined by G De Búrca, 'Fundamental Rights and the Draft Constitutional Treaty' *The European Policy Centre* (2003) <http://www.theepc.be/challenge/topdetail.asp?SEC=documents> (15 September 2003).

policy was inserted in the Amsterdam Treaty with the intention to fill a gap that had been left for too long, thus establishing a better equilibrium between economic and monetary policies. A direct parallel cannot be established between the newly created 'strategy for employment' and the procedures set in motion at Maastricht, in view of the European Monetary Union (EMU). Whereas the latter were built around a well-defined institutional objective and within specific time constraints, the former aimed at the 'promotion' of a high level of employment and of social protection. Still, the attitudes of the relevant institutional actors as well as the techniques adopted were similar: guidelines were set, mechanisms to monitor performances at the national level were established, and recommendations on how to respond to inconsistent policies at the Member State level were issued.

Remaining disparities about policy objectives and difficulties in assigning measurable targets did not stop the reformers of the Treaty of Amsterdam from relying on soft law procedures in both cases. In doing so, they were aware of the fact that sanctions were very different under the two procedures, despite the non-binding nature of commands emanating from the institutions in both cases. The threat of non-admission to different stages preceding the adoption of the single currency was a sanction directly linked to the negative evaluations of the Council (Article 121 TEU). By contrast, only moral sanctions are feasible against states that fail to comply with the employment guidelines. The promotion of a high level of employment was presented in Title VIII as a Community task as well as an aspiration within the economic and political constraints that each national government faces. However, the evaluation mechanism provided for in Article 128 TEU was designed to induce emulation among all Member States and to promote greater consistency in their policy making, while leaving the Member States' prerogatives untouched.

The open method of coordination (OMC), launched at the Lisbon summit[7] was an inventive and well timed continuation of enforcement strategy pursued for Title VIII of the Treaty, which had encouraged mutual learning among Member States and EU institutions.[8] The notion of coordination was — and still is — enshrined in the Treaty, both in Title VII and VIII, and represents yet another facet of the soft law regime on which integration can

[7] Presidency Conclusions, Lisbon European Council, 23–24 March 2000 <http://ue.eu.int/en/Info/eurocouncil/index.htm> (13 January 2003).

[8] Even though some of the targets, such as the raising of average employment rates to 70% and the increasing of research and development spending to 3% of GDP, are currently difficult if not impossible ones for future member states, they are nevertheless part of the learning process which has already been experimented with by the other countries. See W Kok, 'Enlarging the European Union. Achievements and Challenges, Report to the European Commission' *The European University Institute* (Robert Schuman Centre for Advanced Studies, 2003) 44, who thinks that future Member States should be fully involved now in the Lisbon Strategy, without waiting for the completion of the enlargement.

rely and consolidate.[9] In a strict legal sense, sanctions are not compatible with such flexible systems of norms, given the fact that national actors are constantly under pressure to consolidate their position, should their performance be considered slow or inadequate.

Looking at developments outside EU competence, we discover that the adoption of the single currency has incited communication and interaction not only among institutional, but also among non-institutional actors, such as the social partners. Coordination in the form of guidelines responds to an impulse coming from supranational workers organisations that issue guidelines to trade unions, which in turn are engaged in collective bargaining at the national level.[10] This is not to say that private actors are imitating supranational institutions, or that they are compelled to do so. Rather, it confirms that trade unions voluntarily choose to coordinate wage policies as a contribution to the stability of the single currency, offering their own interpretation of the Council's broad economic guidelines with regard to wage moderation.[11]

These are some significant advantages of the openness of the legal system to which new Member States accede and which they have already been involved in as observers of the described processes. As for the richness of the system, current developments indicate the spreading of OMC to other fields, such as social inclusion and pensions.

In this climate, which is characterised by a series of new initiatives that are being promoted by many different actors and involve a continuous exchange of information, the only visible danger is that such an open process of mutual learning might upset the balance between hard and soft law measures. In fact, while celebrating the success of the OMC in employment policies, only framework directives saw the light, signalling a significant 'shift' from one policy strategy to another.[12] The new fixed term work[13] and the part time work[14] directives are both devoted to reducing

[9] S Sciarra, 'Integration through co-ordination. The Employment Title in the Amsterdam Treaty' (2000) 6 *Columbia Journal of European Law* 209 ff; E Szyszczak, 'The Evolving European Employment Strategy' in J Shaw (ed), *Social Law and Policy in an Evolving European Union* (Oxford, Hart Publishing, 2000); D Ashiagbor, 'EMU and the Shift in the European Labour Law Agenda: From "Social Policy" to "Employment Policy"' (2001) 7 *European Law Journal* 311 ff.

[10] Examples of coordination following guidelines addressed to sectoral levels are in T Schulten and R Bispinck (eds), *Collective Bargaining under the Euro. Experiences from the European Metal Industry* (Brussels, ETUI-EMF, 2001).

[11] The experience of the 'Doorn group', named after the location in Belgium where the initiative to launch cross-national coordination started, is reported in G Fajertag (ed), *Collective Bargaining in Europe* (Brussels, ETUI, 2002), in which national reports on some candidate countries and new Member States are included.

[12] As suggested by D Ashiagbor, above at n 9, at p 329.

[13] Council Directive 99/70/EC of 28 June 1999 concerning the framework agreement on fixed-term work concluded by ETUC, UNICE and CEEP [1999] OJ L 175/43.

[14] Council Directive 97/81/EC of 15 December 1997 concerning the Framework Agreement on part-time working concluded by UNICE, CEEP and the ETUC OJ L 128/71.

unemployment and the creation of new employment opportunities. They focus on the principle of equal treatment of all workers, irrespective of the nature of their employment contract. In both cases convergence means requiring that Member States comply with the fundamental equality principle. Strategies for implementation and compliance are not highly prescriptive and leave significant space for differentiation and diversity, rather than forcing a harmonisation of rules. In addition to the fear that an imbalance between hard and soft law might occur, there is another observation prompted by the expansion of OMC, namely that the assessment of statistics on social indicators will make the legal analysis aimed at facilitating the convergence of labour standards redundant.

By extending OMC to social inclusion,[15] the objectives of EU policies have been expanded.

At Lisbon it was suggested that objectives should be set as specific outcomes in the Member States, rather than levels of welfare expenditure. The number of people living below the poverty line — to mention one example — should have been proportionally lowered within a given period of time.

It was also proposed that the existing High-level group on social inclusion should be transformed into a Committee and be inserted in the Treaty.[16] At Nice, following this proposal, it was decided to insert Article 144.[17] A specialised sub-group on social indicators created within the scope of Article 144 has proposed to include financial poverty, income inequality, regional variation in employment rates, long-term unemployment, joblessness, low educational qualifications, low life expectancy and poor health, among the relevant social indicators.[18] Community objectives of such relevance, however, have typically been initiated by the Member States — not a subcommittee at the union level. Agreements by Member States typically represent 'a compromise between the theoretical definition and the empirically possible',[19] with the aim of providing the knowledge-based economy with a solid information basis.

The OMC on social inclusion also treats transparency as an important objective in the governance of diffuse interests, which is relevant for large sectors of civil society.[20] For the new Member States, which are undergoing

[15] Presidency Conclusions, Lisbon European Council, (23–24 March 2000) para 32, above at n 7.
[16] These proposals were put forward at Lisbon by F Vandenbroucke, Belgian Minister for Social Affairs and Pensions. His contributions to the overall debate on reforms in the social field have been remarkable.
[17] Council Decision 2000/436/EC of 29 June 2000 setting up a Social Protection Committee [2000] OJ L 172/26.
[18] As reported by T Atkinson, 'Social Inclusion and the European Union' (2002) 40 *Journal of Common Market Studies* 625 ff.
[19] T Atkinson, B Cantillon, E Marlier and B Nolan, *Social Indicators. The EU and Social Inclusion* (Oxford, Oxford University Press, 2002) 37.
[20] Commission (D-G Employment and Social Affairs) *Joint Report on Social Inclusion* (Luxembourg, Office for Official Publications of the European Communities, 2002).

reforms of their welfare states, this is an open experimental field, in which they can evaluate the experiences of other countries.

Areas covered by the national action plans (NAPs) on social inclusion are different from the ones dealt with in NAPs on employment. In both cases, such plans are meant to specify national governments' intentions in complying with OMC, by indicating legislative or administrative initiatives in certain areas. While employment strategies were first to experiment with and implement OMC, actions to combat social exclusion rely on rich and well structured statistical information.

There are visible links between policy making in social and employment issues, reflected in the terminology adopted in Article 144 of the Treaty. Such concepts are not new in the language of European law, as emerges from reading the 'old' Title XI Treaty of the European Community (ECT) and the 'new' Article 137 TEU in particular. The notion of 'social protection' is central to both areas: it mirrors one of the early historical functions of social security legislation and it challenges protective labour law measures, in as much as it attempts to tailor them not only to people who are in the labour market, but also those who are excluded from it, either because of unemployment or because of a marginal position in employment.

I suggest that comparative labour law research should be expanded in order to demonstrate how wide and comprehensive the notion of social protection can be. Legal analysis can facilitate the understanding of changes inside the labour market and at its margins. Two legal disciplines — labour law and social security law — which have significantly contributed to the consolidation of national welfare systems in the past century, merge together and form a European legal ground for social protection on which to develop a wide notion of labour standards.[21] People working with no entitlements, ie marginal workers within labour markets, pose a new challenge to labour law and social security. They, as well as the socially excluded, are increasingly present in national political agendas.[22]

Comparative research that was undertaken in the early phases of new accessions to the EU acknowledged the diversity of legal traditions. Radical transformations were taking place in these countries in the transition to a market economy, prompting observers to argue that time was needed to assess how the more familiar language of the International Labour

[21] The origin of 'juridification' in labour law and social security is to be found in the need to set limits to contractual freedom and to create adequate institutions able to 'inspect' that employers did comply with legal rules. An historical reconstruction is made by S Simitis, 'The Case of the Employment Relationship: Elements of a Comparison', in W Steinmetz (ed), *Private Law and Social Inequality in the Industrial Age. Comparing Legal Cultures in Britain, France, Germany and the United States* (Oxford, Oxford University Press, 2000).

[22] Mobilising relevant actors to help the most vulnerable groups and to prevent exclusion is the task of European networks. See 'Making a Decisive Impact on Poverty and Social Exclusion? A Progress Report on the European Strategy on Social Inclusion' *European Anti Poverty Network* (2002) <http://www.eapn.org/orders/order3_en.htm> (13 January 2004).

Organisation (ILO) could merge into the developing language of European social law.[23] The 'return' to Europe was — and still is — a good way of framing the transformation as part of a historical process, in which accession to a supranational legal order represents only one element, albeit an extremely important one.

The objective of this paper is to argue that comparative legal analysis should be used to rediscover coherence and cohesion in European labour law. Rather than trying to define the boundaries of the discipline, attempts should be made to strengthen its legal ground, while allowing it to absorb the inputs from economic analysis of the labour market. In the enlarged Europe this should promote convergence of labour standards as a continuous process of mutual learning that is not necessarily contingent on economic performances. Moreover, focusing on labour law constitutes a claim for reconsidering the relevance of labour law's national origin, both in constitutional traditions and in legislation. Values enshrined in national legal orders are a sign of identity not to be dispersed. At the same time, the convergence of labour standards should take into account the fears — as well as the aspirations — of the new Member States. Comparative analysis can correct the perception that European social law is the source of rigidities introduced into national labour markets.[24] It may clarify the function of legal institutions, thus avoiding confusion of concepts, which may be wrongly considered incompatible with the newly established market economies. Especially in collective labour law, anxiety may arise about the fairly common practice of information and consultation between employer and employee organisations.

A widespread Union *acquis* can be mentioned in this field, ranging from a general framework Directive for informing and consulting employees in the European Community,[25] to collective redundancies,[26] transfer of undertakings[27] and European Works Council.[28] The symbolic relevance of

[23] See the results of comparative research in the Czech and Slovak Republics, Hungary and Poland in U Carabelli and S Sciarra (eds), *New Patterns of Collective Labour Law in Central Europe* (Milano, Giuffrè, 1996) and the editors' *Foreword,* explaining the methodology followed by the research team.

[24] Research conducted by the ILO goes into this direction. See P Auer (ed), *The role of institutions and policies* (Geneva, ILO, 2001).

[25] Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community — Joint declaration of the European Parliament, the Council and the Commission on employee representation [2002] OJ L080/29.

[26] Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies [1998] OJ L225/16.

[27] Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses [2001] OJ L082/16.

[28] Council Directive 94/45/EC of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees [1994] OJ L254/64.

such innovation may appear overwhelming for legal systems where only recently privatised companies are still struggling with the difficulty of substituting monolithic states with powerful and representative organisations on the employers' side.[29]

A similarly difficult comparative discussion has been proposed on legal interventions which enhance flexibility in the labour market. In all countries of the European Union national legislatures had to assess very carefully the correct combination of protective measures to be maintained, while pursuing the objective of attenuating legal constraints perceived as strong limits to managerial prerogatives.[30]

Comparative analysis has shown that the closer integration of the common market and the progression towards the adoption of the single currency has induced legal reforms at the national level, which did not bear the marks of a strong ideological divide.[31] Despite the pressure for sound economics and control on public deficits, labour law has maintained its main characteristics in each national setting.[32]

Differences among legal systems as well as different options that are available to national legislatures reflect a delicate balance between new, flexible measures, and old guarantees, including individual and collective guarantees. It is therefore not surprising for comparative labour law to discover that OMC may signal differences in national responses when elaborating NAPs.[33] In practice, open coordination is developing into a methodology that does not pitch European objectives against national priorities of the Member States. By establishing common objectives OMC enhances the opportunities for elaborating national responses that are consistent with the functioning of supranational monitoring institutions.

A provocative question one could pose at this unique moment in the history of European integration as enlargement has become reality,[34] is whether

[29] This was one of the outcomes of the research project edited by Carabelli and Sciarra, quoted above at n 23, namely that rights to information and consultation were perceived as too invasive of employers' economic initiatives in transition economies.

[30] U Carabelli and B Veneziani (eds), *Labour Flexibility and Free Market. A Comparative Legal View from Central Europe* (Milan, Giuffrè, 2002).

[31] N Bermeo (ed), *Unemployment in the New Europe* (Cambridge, Cambridge University Press, 2001) and in particular, the chapter by D Cameron, 'Unemployment, Job Creation and Economic and Monetary Union.'

[32] With the exception of the UK, no drastic deregulatory measures are monitored in the comparative research covering seven major European countries. See G Esping-Andersen and M Regini (eds), *Why Deregulate Labour Markets?* (Oxford, Oxford University Press, 2000).

[33] Communication from the Commission to the Council, the EP, the ESC and the Committee of the Regions, 'Taking Stock of Five Years of the European Employment Strategy' COM (2002) 416 final, (Brussels, 17 July 2002). This is also true for NAPs on social inclusion, as indicated by T Atkinson, above at n 19, 628–9.

[34] The joint declaration adopted at the European Conference in Athens, 17 April 2003, stated already: 'The current enlargement of the European Union is a testimony to the spirit that now prevails on our continent and brings forward the reality of political and economic interdependence between the Union and its neighbours, both to the South and East.'

the expanding scope of OMC will crowd out other regulatory techniques. OMC places much less emphasis on harmonisation, and as such may signal the beginning of a new era, in which labour standards convergence will be pursued only by means of soft law. I suggest that the combination of means and goals, as reflected in the current practice of OMC, has expanded the notion of labour standards and has included procedures among the measures adopted by the Member States. Procedures under OMC emerge from the interpretation of European law and from their adaptation by national administrations in accordance with Treaty obligations. Sufficient scope to manoeuvre is left to national actors, since the 'openness' of the method implies respect for national prerogatives within their jurisdiction. In pursuing their objectives, Member States should, however, comply with the fundamental principles that govern the supranational legal system.

'Harmonisation of the social systems' was not on the minds of the founding fathers of the European communities, who were mostly concerned with the functioning of the common market. Out of respect for national constitutional traditions of the different Member States both in legislation and in adjudication, the harmonisation of social systems has remained a delicate terrain. Thus, the history of European social and labour law should reassure 'future Member States'[35] that rather than entering a full-fledged system of hard and soft rules, they are called upon to contribute to expanding and evolving system.[36]

REGULATORY TECHNIQUES IN EUROPEAN LABOUR AND SOCIAL LAW: THE END OF HARMONISATION?

Today the once privileged regulatory technique in the social field — harmonisation — is at the crossroad of institutional reform, which is hoped to accomplish a better balance between the respective competences of the EU and its Member States. It is also affected by the complexity of labour law reforms required for enhancing the stability of the EMU, while leaving national prerogatives untouched.

There is a striking continuity in the choices of regulatory techniques in the recent history of the EU labour and social law. In the early 1970s, economic and monetary policies were conceived for the creation of a monetary union. They included social measures in employment, social justice and

[35] This is the expression suggested by W Kok, above at n 8.

[36] The Commission has been active in monitoring how new members are respectful of the *acquis* and has made available to them programs on employment and social inclusion. See Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, 'Scoreboard on implementing the social policy agenda' COM(2003) 57 final, para 3.6.

quality of working life.[37] As two astute commentators of European developments have underlined, neither EMU, nor social measures were in the minds of the founding fathers. Nevertheless, the seeds of future developments were there and took the form of a complex and, at times, controversial relationship between the integration of the market and the inclusion of social values.[38]

In the early 1970s 'customary' law[39] brought management and labour into the picture. It took the form of tripartite conferences on issues related to employment and social security that were called by the Council. This in turn promoted the consultation of employer associations and trade unions and the creation of joint committees in various fields of European policies, such as agriculture and transport. Social measures were not conceived as merely ancillary actions within the recognised areas of common policies. Their goal was to create a set of basic guarantees for workers, thus reproducing at the level of European law one of the leading functions of national labour law.

The first enlargement of the European Communities took place in the early 1970s.[40] When Spain and subsequently Portugal joined the EC, the single market program was initiated and new policies began to be developed in environment, economic and social cohesion, research and technology. These examples suggest that 'widening has not prevented deepening'.[41]

Even the recourse to a linguistic metaphor, such as 'social dialogue', which the Single European Act (SEA) inserted into the Treaty, can be interpreted as a cautious recognition of the role played by the social partners and indicates a certain degree of institutional attention to such matters. It also attests that options other than harmonisation were kept open, mostly because of the difficulties incurred when trying to penetrate delicate fields of national policies, such as labour law and social security.

The language adopted in the SEA must be interpreted in strict correlation with the term 'cooperation' previously adopted in the Rome Treaty. In all of these cases, the Commission takes the lead in formulating the objectives

[37] P Werner, *Report to the Council and the Commission on the realization by stages of economic and monetary union in the Community* (Luxembourg, Office for Official Publications of the European Communities, 1970), respectively at 11 and 18.
[38] G and A Lyon-Caen, *Droit Social International et Européen* VIII edn (Paris, Dalloz, 1993) 181.
[39] To borrow the expression used by G and A Lyon-Caen, *ibid* at 179.
[40] Accessions of three new Member States (UK, Denmark and Ireland) took place in 1973. The 1970s were the years in which the launching of the first overall social action program had to be measured against early challenges of the first enlargement.
[41] In the words of W Kok, above at n 8, 22. Spain and Portugal were present in the Intergovernmental Conference preceding the adoption of the Single European Act, before becoming members, as recorded by B de Witte, 'Entry into force and revision' in B de Witte (ed), *Ten Reflections on the Constitutional Treaty for Europe* (Florence, European University Institute, Robert Schuman Centre and Academy of European Law, 2003) 211, welcoming the fact that all 10 candidate countries will participate in the Intergovernmental Conference for the adoption and entry into force of the Constitutional Treaty, without a full membership.

and in stimulating the relevant actors to participate, be they Member States or social partners.

In historical perspective it becomes clear that the tools in the hands of the institutions have not changed much. Instruments of little or no legal relevance, such as the 'encouragement' of cooperation among Member States in crucial labour law matters — listed in the 'old' Article 118 — have been complemented with the inclusion of more specific Treaty provisions. One good example is the inclusion of the 'social dialogue', then further developed in the Maastricht Social Chapter, later incorporated into the TEU. An equally relevant example is the insertion at Amsterdam of Article 13, on combating discrimination on various grounds. The gradually expanding legal recognition of labour and social issues has fuelled the aspirations of those who were hoping to see social principles firmly established in European primary and secondary law.

Given the lack of a clear European jurisdiction, the coordination rather than harmonisation of law was the only technique adopted in social security. Consequently, this subject matter is governed by a strict unanimity rule.[42] In this field, as well as in labour law, the High Authority of the European Coal and Steel Community (ECSC) broke new ground by promoting comparative studies on European social security systems. Moreover, the enforcement of the regulations on social security for migrant workers was administered by a special Commission of Administration assisted by technical advisers.[43] Again, this can be largely explained by the desire of Member States to preserve their national prerogatives in highly sensitive policy areas. However, comparative research has played a crucial role in promoting convergence in policy objectives by offering external expertise and technical assistance to national administrations.

The adoption of the Amsterdam Treaty has brought major changes. Whereas at the beginning of the 1970s the relation between economic and monetary policies on the one hand, and social policies on the other, was rather fragile, the relationship has now become more visible and better structured. The spirit of Title VIII on Employment is such that soft law 'initiatives' are incompatible with harmonisation, as it is clearly stated in Article 129 TEU. The Council 'encourages' and 'supports' cooperation among Member States. It may adopt measures designed to create incentives

[42] The 1958 Regulation concerning social security regimes for migrant workers was conceived well in advance of the coming into force of the Rome Treaty, so that it could undergo a rapid legislative procedure. This is reported by O Kahn-Freund, who valued that Regulation as 'the most significant achievement in legislation altogether.' See O Kahn-Freund, 'Labour Law and Social Security' in E Stein and TL Nicholson (eds), *American Enterprise in the European Common Market. A Legal Profile* (Ann Arbor, The University of Michigan Law School, 1960) at 321.

[43] O Kahn-Freund, *ibid,* 322 ff. The Commission had powers of great importance, in as much as it had to ensure a uniform interpretation of the Regulations and also deal with financial matters.

for increasing employment, but it may not confuse these 'soft' powers with 'hard' legislative measures.

The implementation of Title VIII confirms the potential of a soft law regime, at least when combined with a renewed impetus on promoting coordination between the centre to the periphery within the existing supranational legal system. The same approach can be detected in the implementation of social policy. Article 137 TEU, as amended by the Nice Treaty, excludes 'harmonisation of the laws and regulations of the Member States' from Council's measures associated with soft law, such as the promotion of knowledge, the exchange of information and best practices. Directives, aimed at providing minimum requirements towards the implementation of the measures, may not be adopted in 'the combating of social exclusion' and in 'the modernisation of social protection systems' (Article 137.2 (b)).

Still, Article 137 relies significantly on hard law. It does so, for example, in the area of 'social security and social protection of workers' (Article 137.1 (c)). Importantly, policy areas that are subject to hard law intervention are clearly distinguished from soft law coordination, which applies to 'the modernisation of social protection systems' (Article 137.1 (k)). Article 137 offers a series of interconnected possibilities aimed at enhancing social protection. All measures that fall outside a strict notion of social security are part of social protection measures. They may be coordinated, but not regulated. By contrast, social security may be regulated using directives for setting minimum standards.

Since the early days of the European Economic Community (EEC) social security has served as an important example for how unanimous decision making in the Council may best serve the purpose of protecting national prerogatives. In effect, it has imposed a standstill on supranational legal reform. It is indicative of the new climate brought about by OMC that the Commission is seeking the political consensus necessary for coordinating national health care systems;[44] the modernisation of the rules on free movement of workers[45] and the expansion of Regulation 1408/71 to third country nationals.[46]

[44] 'Questions regarding health and long-term care have not yet been considered in detail within cooperation in social protection', says the Commission in its Communication 'Strengthening the social dimension of the Lisbon strategy: Streamlining open coordination in the field of social protection' COM (2003) 261 final , at sec 2.2, then making a reference to the Joint Report on Health and Long-term Care to the Spring 2003 European Council.

[45] Proposal for a European Parliament and Council Directive on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States, COM (2001) 257 final and the Amended proposal recently adopted by the Commission, COM (2003) 199 final. See also the Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, 'Commission's Action Plan for skills and mobility' COM (2002) 72 final.

[46] Council Regulation (EC) No 859/2003 of 14 May 2003 extending the provisions of Regulation (EEC) No 1408/71 and Regulation (EEC) No 574/72 to nationals of third countries

It would be incorrect to state that as we are approaching the historic enlargement of the EU towards Eastern Europe, policies aimed at promoting common objectives have been reduced to a technique which can be described as 'convergence by guidelines', in line with the soft mechanisms which support OMC. It would also be wrong to think that such a convergence should take place without the 'approximation of provisions provided by law, regulation or administrative action' — an expression dating back to Article 117 of the Rome Treaty and still present in Article 136 TEC. Nor will enlargement proceed without compliance by the new Member States with the 'minimum requirements for gradual implementation' by directives as firmly established for all the areas included in Article 137 TEU.

Recent initiatives by the Commission with respect to the EU social policy agenda [47] show that OMC is expanding in parallel with changes in other substantive areas of law. The new Member States' participation in discussing future reforms of the fundamental freedoms, such as the free movement of workers and the portability of social security and pension rights across the countries[48] will be crucial. In this context it should be noted that a strengthening of individual rights to information and consultation can be an important pre-condition for the enforcement of other rights.[49] Moreover, new Member States should pay attention to health and safety regulations.[50] These areas are a logical extension of labour law, which lies at the intersection of public law — designed to protect and promote the common good — and private law — the purpose of which is to enforce contracts.

The launching of OMC coincided with a phase in which legislative initiative in European social policies has been less frequent, and at times controversial, resulting in the adoption by the Council of framework directives. [51] These framework directives have thus far proved to have only

who are not already covered by those provisions solely on the ground of their nationality [2003] OJ L124/01.

[47] Reported in Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, *Scoreboard on implementing the social policy agenda,* COM (2003) 57 final.

[48] See the Presidency Conclusions, Brussels 20 and 21 March 2003, at para 46, which endorsed the first Tripartite Social Summit for Growth and Employment. See also the Council Decision 2003/174/EC of 6 March 2003 establishing a Tripartite Social Summit for Growth and Employment [2003] OJ L070/31.

[49] Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community — Joint declaration of the European Parliament, the Council and the Commission on employee representation [2002] OJ L080/29.

[50] Communication from the Commission, Adapting to change in work and society: A new Community strategy on health and safety at work 2002–2006, COM (2002) 118 final.

[51] Council Directive 96/34/EC of 3 June 1996 on the framework agreement on parental leave concluded by UNICE, CEEP and the ETUC [1996] OJ L145/4 (amended by Council Directive 97/75/EC of 15 December 1997 to extend the Directive to the United Kingdom); Council Directive 97/81/EC of 15 December 1997 concerning the Framework Agreement on part-time

limited impact on national legal systems. Still, I submit that this remains a wide and interesting field to be cultivated by policy makers and scholars alike. The 'end of harmonisation' may not yet be predicted. Moreover, the expansion of OMC to other policy areas will not imply the end of social policies.

INSTITUTIONAL REFORMS: THE DISCUSSION WITHIN THE 'CONVENTION ON THE FUTURE OF EUROPE'

The developments in the Convention on the Future of Europe have thrown light on the importance of social and employment policies and suggest that the rather negative attitude that has often characterised a significant part of scholarly work in the field[52] should be reconsidered. The importance of social and employment policies should be recognised despite the controversial results of the Convention's Working Group XI on Social Europe. The reason is that the group started to operate much later than the other groups, thus giving it less time to make meaningful recommendations in areas that are highly controversial at the Member State level. Moreover, the group faced substantial political pressure both from Member States and European institutions.

In past scholarly analyses, particularly during the 1980s and the 1990s, the marginal relevance of European social law has been a recurrent theme. Whereas at the end of the 1950s, scholars had been attentive to the expansion of labour law in most national legal systems and to its flourishing as an autonomous discipline, later on they tended to critique European institutions and called for significant reforms. It should, however, be recognised that from the beginning of the 1960s onwards, comparative labour law has contributed to the consolidation of strong national identities. This trend was further corroborated by the creation of well functioning welfare states. Thus, comparative labour law analysis proved an enlightened way to promote a deep understanding of national legal systems. What is now described in the European jargon as a process of mutual learning started in fact a long time ago, when it was not restricted to academic circles, nor isolated from the perception of political change. In other words, what might be called

work concluded by UNICE, CEEP and the ETUC [1998] OJ L014/9 (amended by Council Directive 98/23/EC of 7 April 1998 to extend the Directive to the United Kingdom); Council Directive 1999/70/EC of 28 June 1999 concerning the framework agreement on fixed-term work concluded by ETUC, UNICE and CEEP [1999] OJ L175/43.

[52] An attempt to reconsider this attitude, particularly widespread among labour lawyers, is made by S Giubboni, *Diritti sociali e mercato. La dimensione sociale dell'integrazione europea* (Bologna, Il Mulino, 2003) who offers a complete re-construction of the evolving patterns of European social law.

'the practice of comparative labour law' has greatly influenced legal reform far beyond labour law.

Such a critical approach to European social law developments, founded on rigorous legal analysis, contributed to promote stronger legal intervention at the supranational level and to expand the area of subject matters to be decided by qualified majority voting. It filled with ideas and proposals the debate preceding important political summits and intergovernmental conferences, thus confirming that European developments kept labour lawyers scholarly alert and intellectually vivacious.[53]

Today the relevance of labour law should be reconsidered — particularly in response to the challenges posed by enlargement. Moreover, comparative analysis in this field should be closely associated with a deeper understanding of measures to achieve social inclusion and with the expansion of European social law to third country nationals who are legally residing within the EU territory.[54]

OMC has given renewed impact to the coordination of national strategies. This is evidenced by the developments in employment and social issues, which closely reflect the goals and intentions of major social and political actors at the European and the Member State level. Monitoring by EU institutions is an essential, but by no means exclusive part of this collective exercise. The goals set forth by the EU often coincide with intentions of national authorities, which respond to goal setting at the EU level as well as to the challenges posed by the implementation of these goals into national or subnational administration. Moreover, the implementation process is closely related to the devolution of powers and of competence within each Member State. This process in turn is promoted by structural funds granted by the EU.[55] Comparative analysis should support and complement research on social indicators, both in explaining how labour market institutions work and in showing how various levels of the administration interact in the enforcement of policies.[56]

[53] I have analysed academic debates preceding the Amsterdam Treaty and in particular the 'Simitis Report' in S Sciarra, 'Individuals in Search of Fundamental Social Rights. Current Proposals in the EU' in D Simon and M Weiss (eds), *Zur Autonomie des Individuums, Liber Amicorum Spiros Simitis* (Nomos, Baden-Baden, 2000) 377 ff.

[54] Proposals to adopt EU-wide migration policies and to encourage new Member States to raise social welfare standards are made by T Boeri et al, 'Who's Afraid of the Big Enlargement?' *Centre for Economic Policy Research* (London, Policy Paper no 7, 2002).

[55] T Boeri et al, *ibid,* propose allocation of regional structural funds to national governments, as a measure to integrate new members.

[56] The notion of 'comparable indicators' is very central to the setting of objectives in OMC. See Decision 50/2002/EC of the European Parliament and of the Council of 7 December 2001, establishing a programme of Community action to encourage co-operation between Member States to combat social exclusion [2002] OJ L 10/1, Art 3. A sub-group on social indicators has been established within the Social Protection Committee (Art 144). In a different perspective of policy-making, see the proposals made in a Report by T Boeri and H Brücker, *The Impact of Eastern Enlargement on Employment and Labour Markets in the EU Member*

Despite its belated inclusion in the program of the Convention, the Working Group on Social Europe (Working Group) has confirmed that issues related to social and employment policies are an integral part of European institutional reform. The concise — although possibly too benign — history of social policies in the introductory pages to the Working Group's final report[57] establishes a continuity between the early measures adopted in the Treaty of Rome and the current debate. Although this may appear to be a rhetorical exercise, the Report correctly indicates the historical importance of social regulation for the advancement of the common market. Rather than being marginal, they are presented as functional to different phases of the integration process.

One of the conclusions the Working Group reached is that, in general, the allocation of competence at the European level is adequate. However, an expansion of qualified majority voting could be envisaged to promote Council intervention to enhance functioning of the internal market and the elimination of distortions in competition. These concerns were and continue to be the primary justification for interventions based on hard law. We have seen previously that a lot can be done by way of modernising existing legislation. The Commission has taken this direction especially with regard to the acceding Member States. By contrast, the Working Group has not been too adventurous with regard to hard law and has reserved its energies for innovations through soft law measures.

In some of its passages, the final report of the Working Group captures the spirit of several recent and more political objectives that were established by the Commission. An example is the suggestion to 'streamline' economic and social coordination processes. The report even goes as far as suggesting that the spring European Council should formally be made responsible for achieving coherence among social policy procedures falling under OMC.[58]

The Working Group supports the inclusion of OMC in the Treaty. This is not to undermine the competence of the Member States, but to clarify jurisdiction over procedures that have been used by OMC.[59] This proposal should be read in conjunction with the proposal to clearly establish shared competence in the social field. The implication of this proposal is that OMC can only be adopted in areas where shared EU legislative competence exists. In the social field, the previously mentioned Article 144 TEU is taken as an

States (Berlin and Milan, European Integration Consortium, 2000). The Report argues in favour of developing 'institutions coping with (rather than opposing) structural change' (sec 5, part B).

[57] Final report of the Working Group XI on Social Europe, CONV 516/1/03 REV 1, WG XI 9 (Brussels 4 February 2003) para 2, 3.
[58] *Ibid*, WG XI 9, para 49.
[59] *Ibid*, WG XI 9, sec IV.

example of a well established and functioning process of coordination, which should be preserved and therefore explicitly mentioned in the new constitution.[60]

The language adopted elsewhere in the report reveals an interesting combination of concepts. The report borrows values from the Charter of Fundamental Rights that reflect broad philosophical principles, as well as significant legal concepts: human dignity, solidarity and equality. In the Charter these concepts figure as titles of chapters and indicate different locations for specific fundamental rights. The Working Group mentions them among the values to be included in Article 2 of the Constitutional Treaty. The apparent intention is to expand the objectives of the Union in Article 3.

However, in light of the fact that Article 2 was to be kept 'short and specific', and thus different in scope from the Charter, the decision to include broad social values in this provision is indicative of the attention paid to them in the expected new structure of the draft Treaty. Similarly significant is the suggestion that sanctions against Member States should be used to ensure compliance of social rights.[61]

The Working Group's report fluctuates between a traditional approach to social measures that are practical within a well functioning market on the one hand, and a more innovative one, tailored to the more recent and successful experiments with OMC, on the other. From a somewhat different perspective, the Convention's Working Group on Complementary Competences has suggested that the Treaty should include definitions of policy areas in which 'supporting measures' would apply for assisting and supplementing national policies, without transferring legislative competence to the Union.[62] Employment is listed among such measures. Moreover, if a legal basis was provided for social inclusion, supporting measures should apply to this policy area as well. The interesting and still unclear question is how to link supporting measures to the allocation of credits from the Union budget. This is central to the whole discussion about the expansion of soft law regimes under the OMC and acquires an even stronger relevance in view of enlargement.

Should OMC not be included in the Constitution, it would still continue to operate as an innovative technique within the areas already included in the Treaty and even beyond those. Customary law will continue to play a pivotal role in expanding these innovative procedures.

[60] *Ibid*, WG XI 9, para 47. This proposal reflects the ideas expressed by F Vandenbroucke, Belgian Minister for social affairs and pensions in the Expert hearing held by the Working Group on 21 January 2003. This proposal is also endorsed by G De Burca and J Zeitlin, *Constitutionalising the Open Method of Coordination, Thinking outside the box* (paper 6/2003) <http://www.fd.unl.pt/je/edit_pap2003-06.htm>(13 January 2004).
[61] Above, n 57 WWG XI 9, paras 7, 8, 9.
[62] WG V, Final Report, CONV 375/1/02, REV 1, WG V 14 (Brussels 4 November 2002) para 5.

The micro history of the Convention and of the ideas aired within the various working groups will probably be the object of analysis for years to come. The proposals of the Convention will be measured against the interpretation of the Draft Constitutional Treaty and the subsequent work of the IGC. This will allow for a comparison of two very different methodologies of decision making. In the social field, much of the discussion continues to be dominated by uncertainties about the legal status of the Charter of Fundamental Rights, and even more so about its contents.[63] OMC, the most innovative technique and the one from which so many outcomes are expected, would benefit for its future use and expansion, if a constitutional floor of rights was guaranteed. It is not easy to establish a relationship between procedures and rights. However, it is not impossible to imagine that the respect of fundamental social rights — the best of best practices — becomes one of the leading criteria when exercising mutual learning and one of the resources to be used by European institutions when monitoring and coordinating.

In the Draft Treaty put forward to the IGC[64] Social Policies are dealt with in Part III and still appear trapped in the unanimity clause. This is the case in particular for Article III.104 (c) on social security and social protection, which is unlikely to benefit from any future change of voting mechanisms in Europe. However, Article III.21 deals with social security of both dependent workers and self-employed, thus confirming an important step forward in the construction of a modern system of legal guarantees for working people.

There are only few innovations in the social field. Some concerns have been voiced about the reference to the interpretation by the Presidium of the Constitutional Convention, in the preamble to Part II of the draft constitution. It states that courts shall interpret the charter 'with due regard to the explanations prepared at the instigation of the Praesidium of the Convention which drafted the Charter.' Imposing these kinds of constraints on judicial interpretation is unusual, but it is expected that this provision will be deleted from the final version of the Treaty.

Articles which have, more than others, raised doubts among early commentators on the Draft Treaty are Articles 51 and 52. In Article 51.1, the words 'rights' and 'principles' are used and it is suggested that the former should be justiciable, whereas the latter should be observed by Member States when implementing acts of European Union institutions, but 'they

[63] G De Búrca, 'Fundamental Rights and Citizenship', in B de Witte (ed), *Ten Reflections on the Constitutional Treaty for Europe* (Florence, European University Institute, Robert Schuman Centre and Academy of European Law, 2003), 11 ff.

[64] 'Draft Treaty establishing a Constitution for Europe' *The European Convention* (Brussels, 18 July 2003) <http://european-convention.eu.int/docs/Treaty/cv00850.en03.pdf> (2 March 2004).

shall be judicially cognisable only in the interpretation of such acts and in the ruling on their legality' (Article 52.5). This distinction seems to indicate that certain rights enshrined in the Charter shall be weakened. Furthermore, with regards to Article 52.2, the Praesidium indicates that there is no obligation to enforce principles through legislation or other measures. It is difficult to remain hopeful that social policies would receive an impetus, should this interpretation prevail. The hope is therefore that reformers of the Treaty will not give up, but continue to work on the progressive and continuous modifications of existing rules.

I have argued in this chapter that the value of legal comparison is to be found in a deep understanding of traditions and institutions. In a sensitive area of law — such as labour law — prejudices may develop on matters of preferences and be the product of opposite ideologies. The machinery that has been set in motion by OMC creates the conditions for attenuating contrasts and accentuating points of convergence in a process of mutual respect for national priorities and traditions. For future Member States, this is an ideal context in which learning is closely associated with instructing on future developments and accepting change as part of a constantly evolving multilevel system of rules.

References

Ashiagbor, D (2001) 'EMU and the Shift in the European Labour Law Agenda: From "Social Policy" to "Employment Policy" ' 7 *European Law Journal* 311.

Atkinson, T (2002) 'Social Inclusion and the European Union' 40 *Journal of Common Market Studies* 625.

Atkinson, T, Cantillon, B, Marlier, E, Nolan, B (2002) *Social Indicators. The EU and Social Inclusion* (Oxford, Oxford University Press).

Auer, P (2001) *The Role of Institutions and Policies* (Geneva, International Labour Office).

Bermeo, N (ed), (2001) *Unemployment in the New Europe* (Cambridge, Cambridge University Press).

Boeri, T and Brücker, H (2000) 'The Impact of Eastern Enlargement on Employment and Labour Markets in the EU Member States' (Berlin and Milan, European Integration Consortium).

Boeri, T et al (2002) 'Who's Afraid of the Big Enlargement?' *Centre for Economic Policy Research* (London, Policy Paper) n 7.

Cameron, D (2001) 'Unemployment, Job Creation and Economic and Monetary Union' in N Bermeo (ed), *Unemployment in the New Europe* (Cambridge, Cambridge University Press).

Carabelli, U and Sciarra, S (eds), (1996) *New Patterns of Collective Labour Law in Central Europe* (Milano, Giuffrè).

Carabelli, U and Veneziani, B (2002) *Labour Flexibility and Free Market. A Comparative Legal View from Central Europe* (Milano, Giuffrè).

De Búrca, G (2001) 'The Drafting of the EU Charter of Fundamental Rights' *European Law Review* 126.

—— (2003) 'Fundamental Rights and Citizenship' in B de Witte (ed), *Ten Reflections on the Constitutional Treaty for Europe* (European University Institute, Robert Schuman Centre and Academy of European Law, Florence).

—— (2003) 'Fundamental Rights and the Draft Constitutional Treaty' *The European Policy Centre* (27 March 2003).

De Burca, G and Zeitlin, J (2003) 'Constitutionalising the Open Method of Coordination, Thinking Outside the Box' *Jurist-Thinking Outside the Box Editorial Series*.

De la Porte, C and Pochet, P (eds), (2002) *Building Social Europe through the Open Method of Coordination* (Brussels, Observatoire Social Européen).

De Witte, B (2003) 'Entry into force and revision' in B de Witte (ed), *Ten Reflections on the Constitutional Treaty for Europe* (Florence, European University Institute, Robert Schuman Centre and Academy of European Law).

Esping-Andersen, G and Regini, M (eds), (2000) *Why Deregulate Labour Markets?* (Oxford, Oxford University Press).

European Anti Poverty Network (2002) 'Making a Decisive Impact on Poverty and Social Exclusion? A Progress Report on the European Strategy on Social Inclusion.'

Fajertag, G (ed), (2002) *Collective Bargaining in Europe* (Brussels, ETUI).

Giubboni, S (2003) *Diritti sociali e mercato. La dimensione sociale dell'integrazione europea* (Bologna, Il Mulino).

Kahn-Freund, O (1960) 'Labour Law and Social Security' in Stein, E and Nicholson, TL (eds), *American Enterprise in the European Common Market. A Legal Profile* (Ann Arbor, The University of Michigan Law School).

Kahn-Freund, O (1978) 'On Uses and Misuse of Comparative Law' 37 *Modern Law Review* 1 and in *Selected Writings* (London, Stevens).

Kok, W (2003) 'Enlarging the European Union. Achievements and Challenges, Report to the European Commission' *European University Institute* (Florence, Robert Schuman Centre for Advanced Studies).

Lyon-Caen, G and A (1993) *Droit Social International et Européen* VIII edn (Paris, Dalloz).

Schulten, T and Bispinck, R (eds), (2001) *Collective Bargaining under the Euro. Experiences from the European Metal Industry* (Brussels, ETUI-EMF).

Sciarra, S (2000) 'Individuals in Search of Fundamental Social Rights. Current Proposals in the EU' in D Simon and M Weiss (eds), *Zur*

Autonomie des Individuums, Liber Amicorum Spiros Simitis (Nomos, Baden-Baden).

—— (2000) 'Integration through co-ordination. The Employment Title in the Amsterdam Treaty'6 *Columbia Journal of European Law* 209.

Simitis, S (2000) 'The Case of the Employment Relationship: Elements of a Comparison' in W Steinmetz (ed), *Private Law and Social Inequality in the Industrial Age. Comparing Legal Cultures in Britain, France, Germany and the United States* (Oxford, Oxford University Press).

Simon, D and Weiss, M (2000) *Zur Autonomie des Individuums, Liber Amicorum Spiros Simitis* (Nomos, Baden-Baden).

Szyszczak, E (2000) 'The Evolving European Employment Strategy' in J Shaw (ed), *Social Law and Policy in an Evolving European Union* (Oxford, Hart Publishing).

Werner, P (1970) *Report to the Council and the Commission on the realization by stages of economic and monetary union in the Community* (Luxembourg, Office for Official Publications of the European Communities).

7

The EU Agenda for Regulating Labour Markets: Lessons from the UK in the Field of Working Time

CATHERINE BARNARD

INTRODUCTION

REGULATION OF SOCIAL policy in the EU has undergone a remarkable transformation. After an initial period when there was little express Community competence to legislate over social matters and even less desire to do so, the Member States changed their view. This led to the enactment of an eclectic, but nevertheless substantial, corpus of Community rules, including a swathe of directives on health and safety. In part, this legislation was about social rights for citizens; but it was also about ensuring a level playing field for companies in which they could compete on equal terms in respect of costs.[1] Generally, this legislation was characterised by hard law rules which were often directly effective. The method for enacting such rules varied, as did their form and content, but the result was the same: top down, command and control-style regulation backed by enforcement by the Member States. This was the essence of the classic Community method identified in the Governance White Paper[2] and has been reinforced by the Charter of Fundamental Rights.

The Amsterdam Treaty and the Luxembourg summit marked a significant change in approach. In respect of employment matters, the focus shifted from employment law to employment policy,[3] from hard law to soft, and from regulation to coordination and decentralisation. This was demonstrated

[1] Case 43/75 *Defrenne (No. 2) v SABENA* [1976] ECR 455.
[2] Commission of the European Communities, European Governance COM (2001) 428 final (25 July 2001) (White Paper). See J Scott and D Trubek, 'Mind the Gap: Law and New Approaches to Governance in the European Union' (2002) 8 *European Law Journal* 1.
[3] See M Freedland, 'Employment Policy' in P Davies, A Lyon-Caen, S Sciarra and S Simitis (eds), *European Community Labour Law: Principles and Perspectives (Liber Amicorum Lord Wedderburn of Charlton)* (Oxford, Clarendon, 1996).

most clearly by the Luxembourg process which aimed at the attainment of a high level of — and subsequently full — employment, and the Lisbon summit which set the Union the goal of becoming 'the most competitive and dynamic, knowledge based economy in the world.'[4] Member States were to compare best practice to achieve targets laid down centrally. The new approach was based on the promotion of mutual learning, enhancement of coordination between levels of government, integration of separate policy domains, enhanced participation (a process which involved a wide range of actors, in particular the social partners) and promotion of convergence while allowing diversity.[5] This approach also dovetailed with wider debates about different methods of governance in the EU.

The accession states, with their own labour law traditions, will have to adapt to both the old and new models of EC regulation of social matters, models whose construction they had no influence over. The aim of this paper is to look at the problems experienced by another state, the UK, also a late joiner to the EU, to see how it has adapted to the challenge of signing up to the EU model of social regulation. This examination will take *working time* as a case study, and in particular the implementation of Directive 93/104/EC[6] (Working Time Directive). In the UK there is a culture of long working hours which, unlike Continental Europe and, to a certain extent, the former Eastern European countries, has largely been unrestricted by state intervention due to the UK's tradition of state abstentionism or *laissez-faire*. Directive 93/104 limited the working week to 48 hours, including overtime. However, the Directive also provided that the limit did not apply to workers who agreed to waive their rights under the so-called Article 18(1)(b)(i) opt-out. This opt-out is currently subject to review by the Commission. The UK implemented this opt-out into UK law and, according to research conducted by Simon Deakin, Richard Hobbs and myself,[7] employers and their workers have taken full advantage of it. This tells us quite a lot about how a rule which was drafted against one set of cultural norms does not transplant easily.[8] A number of accession states will soon discover this as they also take advantage of the opt-out.

[4] Presidency Conclusions, Lisbon European Council, 23–4 March 2000 <http://ue.eu.int/en/Info/eurocouncil/index.htm> (17 December 2003).
[5] J Mosher and D Trubek, 'EU Social Policy and the European Employment Strategy' (2003) 41 *Journal of Common Market Studies* 63, 79–80.
[6] Council Directive 93/104/EC of 23 November 1993 concerning certain aspects of the organisation of working time [1993] OJ L307/18 (the Working Time Directive). This has been consolidated by European Parliament and Council Directive 2003/88 (OJ [2003] L299/9) which comes into force on 2 August 2004.
[7] The research was largely conducted during 2002 based on a series of interviews with government departments and services, representatives of employers and employees and 10 case study employers from across five different sectors. The sectors chosen were (1) Education, (2) Health, (3) Manufacturing, (4) Financial and Legal Services and (5) Hotel and Catering.
[8] On the difficulties of cross-cultural transplants, see also S Soltysinski and R Buxbaum, both in this volume.

This case study also sends out a more general warning to the EU as a whole. Since the Luxembourg and Lisbon summits, the issue of working time, in particular its 'modernisation', has become a major preoccupation. The provisions of the Working Time Directive, and subsequent amendments, were originally drafted to achieve one objective (employment rights and health and safety). They have now been called in aid to help realise the ambitious Luxembourg agenda (modernisation of the European Social Model and full employment). As we shall see, the UK's experience suggests that the implementation of the directive has not delivered the expected results. With enlargement it is likely that the accession states will have a similar tale to tell.

The paper begins by examining the different methods for regulating the EU labour market before turning to consider the Working Time Directive and its implementation in the UK. It will then examine the limited extent to which the directive has helped to deliver on the Lisbon and Luxembourg goals.

METHODS FOR REGULATING THE EU LABOUR MARKET

The Early Days

In 1957 the Treaty of Rome left virtually all matters relating to the regulation of labour markets and the welfare state to individual Member States,[9] in part because the states themselves were determined to keep social policy as a domestic issue and in part due to the classic neo-liberal belief that successful market integration would lead to a raising of the standard of living. As a result, only a few social policy provisions with limited effects were included in the original Treaty, emphasising the need to improve working conditions and co-operation between states.[10] Specific provisions on equal pay and paid holiday schemes, designed to protect French industry against unfair competition (or 'social dumping'), were also included.[11]

However, this approach was largely superseded in the 1970s and 1980s by a selective use of harmonisation. Such legislation was largely premised on the need to address the problems faced by the 'losers' — both individuals and companies — suffering from the consequences of European integration. Failure to have developed any kind of social policy might have jeopardised the whole process of economic integration. As a result, the Commission drew up an Action Programme which precipitated a phase of remarkable legislative

[9] For a more detailed discussion of this evolution, see C Barnard and S Deakin, '"Negative" and "Positive" Harmonisation of Labor Law in the European Union' (2002) 8 *The Columbia Journal of European Law* 389.
[10] Arts 117 and 118 of the EC Treaty (now Arts 136 and 140 of the EC Treaty).
[11] Arts 119 and 120 of the EC Treaty (now Arts 141 and 143 of the EC Treaty).

activity: Directives were adopted in the field of sex discrimination,[12] an action programme and a number of directives were adopted in the field of health and safety and, in the face of rising unemployment, measures were taken to ease the impact of mass redundancies, in particular directives on the transfer of undertakings, and insolvent employers.[13] The introduction of a new legal basis, Article 118a, by the Single European Act 1986 facilitated the adoption of additional social measures, such as the Pregnant Workers' Directive[14] and the Young Workers' Directive[15] and, most importantly for our purposes, the Working Time Directive.[16] These all resulted from the Social Charter Action Programme which accompanied the 1989 Social Charter of Fundamental Rights.

But this period cannot be stereotyped as one in which the legislation adopted was aimed at exhaustive harmonisation. Given the very different industrial relations backgrounds of the Member States, the social directives have always combined setting social standards at EU level with the need for flexibility for the Member States.[17] For example, most of the social directives, including those which predated Article 118a, laid down only minimum standards upon which Member States were free to improve. In addition, much of the harmonisation was only partial: Community law lay down certain key standards but much was left to the Member States.[18]

[12] Council Directive 75/117 of 10 February 1975 on the approximation of the laws of the Member States relating to the application of the principle of equal pay for men and women ([1975] OJ L45/19), Council Directive 76/207 of 9 February 1976 on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion and working conditions ([1976] OJ L39/40) and Council Directive 79/7 of 19 December 1978 on the progressive implementation of the principle of equal treatment for men and women in matters of social security ([1979] OJ L6/24).

[13] Council Directive 75/129/EEC of 17 February 1975 on the approximation of the laws of the Member States relating to collective redundancies [1975] OJ L48/29; Council Directive 77/187/EEC of 14 February 1977 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses [1977] OJ L61/27; and Council Directive 80/987/EEC of 20 October 1980 on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer ([1980] OJ L283/23) respectively.

[14] Council Directive 92/85/EEC of 19 October 1992 on the introduction of measures to encourage improvements in the safety and health at work of pregnant workers and workers who have recently given birth or are breastfeeding [1992] OJ L348/1.

[15] Council Directive 94/33/EC of 22 June 1994 on the protection of young people at work [1993] OJ L216/12.

[16] Council Directive 93/104/EC of 23 November 1993 concerning certain aspects of the organization of working time [1993] OJ L307/18.

[17] C Barnard, 'Flexibility and social policy' in G De Búrca and J Scott (eds), *Constitutional Change in the EU: From Uniformity to Flexibility?* (Oxford, Hart Publishing, 2000).

[18] See, eg, Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses [2001] OJ L82/16 considered in Case 105/84 *Foreningen af Arbejdsledere i Danmark v A/S Danmols Inventar* [1985] ECR 2639, para 26.

That said, the social measures adopted in this period owed more to the classic Community method than those which were to follow. In this respect, the Maastricht Treaty marked a watershed. The social provisions of this new Treaty, and the legislation adopted under it, contained elements of what have subsequently been termed 'reflexive harmonisation': regulatory learning within a hard law framework. The amendments of the Treaty's social provisions allowed the Social Partners (representatives of management and labour) to negotiate collective agreements[19] which could be given *erga omnes* effects by a Council 'decision'.[20] Three intersectoral agreements (on parental leave, part-time work and fixed-term contracts)[21] and two sectoral agreements (on working time for seafarers and for pilots and cabin crew)[22] have been negotiated via this method. These framework directives in turn, create space for national and subnational actors to act, implementing the directives and fleshing out the detail of the rules.

The Council itself has also adopted directives which incorporated space for regulatory learning. For example, the European Works Councils Directive[23] did not set out directly to impose any particular model of employee representation. Instead, it provided the transnational companies coming within its scope with an incentive to enter into negotiations with employee representatives for the establishment of a works council or a similar mechanism

[19] Art 4(1) (new Art 139(1)). See generally B Bercusson, 'Maastricht — a Fundamental Change in European Labour Law' (1992) 23 *Industrial Relations Journal* 177; and B Bercusson, 'The Dynamic of European Labour Law after Maastricht' (1994) 23 *Industrial Law Journal* 1.

[20] Art 4(2) (new Art 139(2)). The term 'decision' is not used in the sense of Art 249 but has been interpreted to mean any legally binding act, in particular, directives.

[21] The Directive on Parental Leave (Council Directive 96/34/EC of 3 June 1996 on the framework agreement on parental leave concluded by UNICE, CEEP and the ETUC (OJ L145,19.6.96, p 4)); Council Directive 97/81/EC of 15 December 1997 concerning the Framework Agreement on part-time work concluded by UNICE, CEEP and the ETUC — Annex : Framework agreement on part-time work (OJ 1998 L14/9); and Council Directive 1999/70/EC of 28 June 1999 concerning the framework agreement on fixed-term work concluded by ETUC, UNICE and CEEP (OJ 1999 L175/43) respectively.

[22] Directive 1999/95/EC of the European Parliament and of the Council of 13 December 1999 concerning the enforcement of provisions in respect of seafarers' hours of work on board ships calling at Community ports ([2000] OJ L14/29) and Council Directive 2000/79/EC of 27 November 2000 concerning the European Agreement on the Organisation of Working Time of Mobile Workers in Civil Aviation concluded by the Association of European Airlines (AEA), the European Transport Workers' Federation (ETF), the European Cockpit Association (ECA), the European Regions Airline Association (ERA) and the International Air Carrier Association (IACA) [2000] OJ L302/57 respectively.

[23] Council Directive 94/45/EC of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees [1994] OJ L254/64, as amended by Council Directive 97/74/EC of 15 December 1997 extending, to the United Kingdom of Great Britain and Northern Ireland, Directive 94/45/EC on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community — scale groups of undertakings for the purposes of informing and consulting employees [1998] OJ L10/22; consolidated legislation [1998] OJ L10/20.

for information and consultation by using a default procedure in the event of the failure of negotiations.

Amsterdam, Luxembourg and Lisbon

The period after the Amsterdam Treaty was characterised by soft law regulatory techniques based on convergence and coordination. This change in emphasis was first signalled by the Luxembourg Employment Strategy developed to support the attainment of the new Employment Title introduced by the Amsterdam Treaty.[24] According to Article 125:

> Member States and the Community shall, in accordance with this Title, work towards developing a co-ordinated strategy for employment and particularly for promoting a skilled, trained and adaptable workforce and labour markets responsive to economic change with a view to achieving the objectives defined in Article 2 of the Treaty on European Union and in Article 2 of this Treaty.

These objectives include attaining a 'high level of employment'. The European Council decided to put the relevant provisions of the new Title on Employment into effect before the Treaty of Amsterdam came into force. This was agreed at an Extraordinary meeting of the European Council in Luxembourg on 20–21 November 1997 (the so-called Jobs Summit). Under the 'Luxembourg process' the first guidelines outlining policy areas for 1998 were agreed to by the Member States and adopted by the Council of Ministers.[25] The Member States were then obliged to incorporate these guidelines into National Action Plans (NAPs). The Luxembourg guidelines centred on four main 'pillars':[26] *employability* which focuses on the prevention of long term and youth unemployment; *entrepreneurship* which attempts to make the process of business start-ups more straightforward; *adaptability* which encourages negotiation over the improvement of productivity through the reorganisation of working practices and production processes; and *equal opportunities* which is concerned with raising awareness of issues relating to gender equality in terms of equal access to work, family friendly policies, and the needs of people with disabilities.

The need to strengthen employment levels was reinforced at Lisbon where the Union set itself a new strategic goal: 'to become the most competitive and dynamic knowledge-based economy in the world, capable

[24] See also M Biagi, 'The Implementation of the Amsterdam Treaty with Regard to Employment: Coordination or Convergence?' (1998) 14 *International Journal of Comparative Labour law and industrial Relations* 325; S Sciarra, 'Integration through Coordination: The Employment Title in the Amsterdam Treaty' (2000) 6 *Columbia Journal of European Law* 209.
[25] Council Resolution of 15 December 1997 on the 1998 Employment Guidelines [1998] OJ C30/1.
[26] See Barnard and Deakin, above, n 9, 117.

of sustainable economic growth with more and better jobs and greater social cohesion.'[27] The attainment of this goal was based on an overall strategy aimed at preparing the transition to a knowledge-based economy, modernising the European social model and sustaining the healthy economic outlook and favourable growth prospects.

The Luxembourg process forms a key part of this strategy. It is designed to enable the Union to regain the conditions for full employment, and to strengthen regional cohesion in the European Union.[28] However, the 2003 employment guidelines[29] replaced the four pillars with three 'overarching and interrletated objectives' of 'full employment, quality and productivity at work, and social cohesion and inclusion'.[30] These overarching objectives are then fleshed out by 10 specific guidelines which, to a certain extent, reflect the original four pillars.

Implementation of the Lisbon strategy is to be achieved by 'improving the existing processes, introducing a new open method of coordination (OMC) at all levels, coupled with a stronger guiding and coordinating role for the European Council to ensure more coherent strategic direction and effective monitoring of progress.'[31] This method, which is designed to help Member States progressively develop their own policies, involves fixing guidelines for the Union combined with specific timetables for achieving the goals, establishing quantitative and qualitative indicators and benchmarks as a means of comparing best practice; translating these European guidelines into national and regional policies and periodic monitoring, evaluation and peer review organised as mutual learning processes.[32]

OMC envisages the involvement of a wide range of economic actors: the Member States, regional and local levels, the social partners and civil society. The value of this decentralised, multilevel approach was emphasised in the context of the debate occurring in the EU, at much the same time that the emphasis was on the quality of governance in the EU. The Governance White Paper[33] said that civil society,[34] and in particular

[27] Above, n 4.
[28] Above n 4, para 6.
[29] Council Decision 2003/578/EC (OJ [2003] L197/13).
[30] Annex, 17.
[31] Para 7.
[32] Para 37.
[33] COM (2001) 428. See also the Commission of the European Communities, Communication Promoting Core Labour Standards and Improving Social Governance in the Context of Globalisation: COM (2001) 416.
[34] According to the Governance White Paper COM(2001) 428 (above n 2), civil society includes the following: trade unions and employers' organisations ('social partners'); non-governmental organisations; professional associations; charities; grass-roots organisations; organisations that involve citizens in local and municipal life with a particular contribution from churches and religious communities. For a more precise definition of organised civil society, see the Opinion of the Economic and Social Committee on 'The role and contribution of civil society organisations in the building of Europe' [1999] OJ C329/30. COM (2001) 428, 14.

the social partners, play 'an important role in giving voice to the concerns of citizens' and delivers 'services that meet people's needs.'[35] The social partners are prioritised in respect of the social dialogue with the added encouragement to 'use the powers given under the Treaty to conclude voluntary agreements.'[36]

This idea of broadening the base of those involved in the decision making process, together with the need to modernise the European Social Model,[37] while promoting quality,[38] were the central themes of both the Commission[39] and the Nice Council's European Social Agenda.[40] The Commission's Agenda is based on 'an improved form of governance … providing a clear and active role for all stakeholders and actors.'[41] As the Commission notes, 'The development of social dialogue at European level, as a specific component of the Treaty, is a key tool for the modernisation and further development of the European social model, as well as the macro-economic strategy.'[42] This was endorsed by the European Council at Nice which recognised that in modernising and deepening the European social model 'all due importance' had to be given to the social dialogue.[43]

[35] *Ibid*.
[36] C Barnard and S Deakin, 'Corporate Governance, European Governance and the Role of Social Rights' in B Hepple (ed), *Social and Labour Rights in a Global Context: International and Comparative Perspectives* (Cambridge, CUP, 2002).
[37] The Nice European Council offered a definition of the European social model (annex I, para 11): 'The European Social Model, characterised in particular by systems that offer a high level of social protection, by the importance of the social dialogue and by services of general interest covering activities vital for social cohesion, is today based … on a common core of values.' These values are outlined in para 11, 'solidarity and justice as enshrined in the Charter of Fundamental Rights', and para 23, 'Social cohesion, the rejection of any form of exclusion or discrimination and gender equality.'
[38] This was particularly referred to in the annex to the Nice European Council Presidency Conclusions: 'Quality of training, quality in work, quality of industrial relations and quality of social policy as a whole are essential factors if the European Union is to achieve the goals it has set itself regarding competitiveness and full employment. The implementation of this approach and action taken at Community level must be aimed more particularly, subject to the principle of subsidiarity and giving all due importance to the social dialogue, at ensuring the achievement of common objectives' (para 26). See also the Commission's Communication, *Employment and social policies: a framework for investing in quality,* COM (2001) 313.
[39] Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, Social Policy Agenda COM (2000) 379 final (28 June 2000). In the light of the new policy of OMC, there is now a Commission Communication, Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, Scoreboard on implementing the social policy agenda COM (2001) 104 final (22 February 2001).
[40] The social partners also have to play their full part in implementing and monitoring the European Social Agenda — above n 37 at para 14.
[41] Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, Social Policy Agenda, COM (2000) 379, 14 (28 June 2000).
[42] *Ibid*, COM (2000) 379, 23.
[43] Above n 37, at Annex I, para 26.

Member State governments and the social partners were not alone in being harnessed to the yoke of this reform agenda. The Lisbon European Council made a special appeal to companies' corporate sense of social responsibility (CSR) regarding best practices on lifelong learning, work organisation, equal opportunities, social inclusion and sustainable development. This led to a Green Paper on Promoting a European Framework for CSR, followed by a Council Resolution[44] which emphasises the role of all 'stakeholders' in achieving social responsibility. It says that CSR can be a means of responding to the challenges of organisational changes within undertakings and new production arrangements. It continues that:

> Implementation of corporate social responsibility within businesses can be facilitated by the participation of workers and their representatives in a dialogue that promotes exchanges and constant adaptation.[45]

This brief review of the past and present EU agenda demonstrates the seismic shift in the Community's approach towards regulating the EU labour market. As we shall see in the next section, the Working Time Directive was drafted (and adopted) under the classic community method with a view to achieving one objective (employment rights) but is now being seen as part of the broader agenda of employment policy, and in particular, job creation. This inevitably creates tensions, tensions which were exacerbated when the provisions of the directive came to be applied at national, sub-national and enterprise level.

CASE STUDY OF WORKING TIME

The Working Time Directive

Prior to the enactment of Directive 93/104 there had existed some sectoral legislation on working time[46] and some soft law measures. These included a Council Recommendation of 1975 on the principle of the 40-hour week and four weeks annual paid holiday,[47] and a Resolution of 1979 on the adaptation of working time,[48] aimed primarily at the reduction in working

[44] Council Resolution on the follow-up to the Green Paper on corporate social responsibility 2002/C 86/03, [2002] OJ C86/3), para 10.
[45] *Ibid*.
[46] Regulations limiting the working hours of drivers of larger passenger vehicles and most goods vehicles over 3.5 tonnes. Council Regulation (EEC) 3820/85 of 20 December 1985 on the harmonisation of certain social legislation relating to road transport [1985] OJ L370/1; Council Regulation (EEC) 3821/85 of 20 December 1985 on recording equipment in road transport [1985] OJ L370/8, Arts 2 and 4.
[47] Council Recommendation 75/457/EEC of 22 July 1975 on the principle of the 40-hour week and the principle of four weeks' annual paid holiday [1975] OJ L199/32, 32.
[48] Council recommendation 82/857/EEC of 10 December 1982 on the principles of a Community policy with regard to retirement age [1982] OJ L357/27.

time for the purposes of job creation.[49] The Community Social Charter 1989 marked a change in emphasis. Articles 7 and 8 advocated action on the duration and organisation of working time so that the completion of the internal market led to an improvement in the living and working conditions of workers in the EU. This enabled the Commission to conceive a directive on working time not as a job creation measure but a health and safety matter, enabling it to select Article 118a (new Article 137) as the appropriate legal basis. To support its choice, the Commission cited a variety of studies which variously showed that weekly working time of more than 50 hours could, in the long run, be harmful to health and safety, that working weeks of more than six days showed some correlation with health problems including fatigue and disturbed sleep, and that longer working hours substantially increased the probability of accidents at work.[50] This evidence was, however, disputed by some[51] and the UK subsequently mounted a (largely unsuccessful) challenge to the choice of legal basis.[52]

Directive 93/104[53] limits working time to 48 hours per week over a reference period of four months, and it also limits night work. In addition, it contains entitlements to daily, weekly and annual rest breaks. It applies to all sectors of activity, both public and private, but, as originally conceived, did not apply to those working in the transport industry, the activities of doctors in training and certain specific activities such as the armed forces or to the police.[54] Subsequently, two sectoral directives were successfully negotiated at European level for the airline industry and for seafarers to extend some of the provisions of the directive to these groups. These agreements were given *erga omnes* effect by a Council Directive. [55] A further directive has also been adopted extending the provisions of Directive 93/104 to the excluded sectors.[56]

[49] See also Council Recommendation 82/857/EEC of 10 December 1982 on the principles of a Community policy with regard to retirement age [1982] OJ L357/27 which also has the objective of lower activity levels.
[50] Proposal for a Council Directive concerning Certain Aspects of the Organisation of Working Time COM (90) 317 final.
[51] See B Bercusson, 'Working Time in Britain: Towards a European Model, Part I' (1993) *Institute of Employment Rights* 4.
[52] Case C—84/94 *UK v Council* [1996] ECR I-5755.
[53] Council Directive 93/104/EC of 23 November 1993 concerning certain aspects of the organization of working time [1993] OJ L307/18.
[54] Art 1(3) of Council Directive 93/104/EC.
[55] European Parliament and Council Directive 99/95/EC concerning the enforcement of provisions in respect of seafarers' hours of work on board ships calling at Community ports [2000] OJ L14/29 and Council Directive 2000/79/EC of 27 November 2000 concerning the European Agreement on the Organisation of Working Time of Mobile Workers in Civil Aviation concluded by the Association of European Airlines (AEA), the European Transport Workers' Federation (ETF), the European Cockpit Association (ECA), the European Regions Airline Association (ERA) and the International Air Carrier Association (IACA) [2000] OJ L302/57 respectively.
[56] Directive 2000/34/EC of the European Parliament and of the Council of 22 June 2000 amending Council Directive 93/104/EC concerning certain aspects of the organisation of

The directive also contains a complex series of derogations which Member States can choose to apply. For example, most of the directive's provisions, including the maximum 48-hour week, do not apply to workers whose working time is not measured and/or predetermined or can be determined by the workers themselves', such as managing executives or others with autonomous decision-taking powers, family workers and 'religious' workers.[57] In particular the limits on working time do not apply to these workers. There are also derogations in respect of those working in industries requiring 24-hour a day cover and those doing shift work. In addition, the directive allows derogations from the provisions on rest entitlements and the reference periods by means of collective agreements or agreements between the two sides of industry at national or regional level.[58] The directive also allows Member States to take advantage of two 'transitional' provisions. One, concerning annual leave, has now expired. The other, concerning the possibility for individuals to opt-out from the 48-hour working week, was due for review in 2003.[59]

From this brief survey, it can be seen that the Working Time Directive straddles both the old and new approaches to regulation. On the one hand, it was adopted under the old-regime and so manifests many of the qualities of hard law: it is legally binding and generally directly effective. However, it also incorporates degrees of flexibility. For example, as its health and safety legal basis dictated,[60] it set only minimum standards which states could improve on. It also contained a variety of derogations and exceptions; it made provision for delayed implementation; and it envisaged a significant role for the social partners. To that extent the directive also demonstrated some of the qualities of the new approach.

The Need to Reform Working Time Arrangements in Order to Help Realise the Luxembourg and Lisbon Objectives

The literature surrounding the Luxembourg and Lisbon programmes views working time issues as crucial to the reform agenda. For example, reform

working time to cover sectors and activities excluded from that Directive [2000] OJ L195/41. See also Directive 2002/15/EC of the European Parliament and of the Council of 11 March 2002 on the organisation of the working time persons performing mobile road transport activities [2002] OJ L80/35.

[57] Art 17(1) of Directive 93/104.

[58] Art 17(3), para 1. Where it is in conformity with the rules laid down by such agreements, derogations can be made by means of collective agreements or agreements between the two sides of industry at a lower level (Art 17(3), para 1). Member States may allow derogations by collective agreement or agreement between the two sides of industry at the appropriate collective level where there is no system for ensuring the conclusion of collective agreements or agreements between the two sides of industry or member states where there is a specific legislative framework (Art 17(3), para 2).

[59] Art 18(1)(b)(i).

[60] Art 118a (now Art 137).

of working time is part of the process of modernising work organisation which is central to the adaptability pillar of the employment guidelines. This can be seen in the 2002 employment guidelines[61] which provide:

> In order to promote the modernisation of work organisation and forms of work, which inter alia contribute to improvements in quality of work, a strong partnership should be developed at appropriate levels (European, national, sectoral, local and enterprise levels).[62]

They continue that the *social partners* are invited:

> [T]o negotiate and implement at all appropriate levels agreements to modernise the organisation of work, including flexible working arrangements, with the aim of making undertakings productive, competitive and adaptable to industrial change, achieving the required balance between flexibility and security, and increasing the quality of jobs.[63]

Subjects to be covered include the introduction of new technologies, new forms of work and working time issues such as the expression of working time as an annual figure, the reduction of working hours, the reduction of overtime, the development of part-time working, access to career breaks, and associated job security issues. Of this list, the Working Time Directive deals only with the first three issues. At the same time, *Member States* are encouraged to facilitate the introduction of modernised work organisation and ensure a better application of existing health and safety legislation.[64] In the 2003 guidelines the Member States also commit themselves to promoting 'diversity of contractual and working arrangements, including arrangements on working time'[65] and to recognising 'the special importance of health and safety at work, innovative and flexible forms of work organisation'.[66]

In much the same vein, under the heading 'Anticipating and capitalising on change in the working environment by creating a new balance between flexibility and security', the Nice European Council Conclusions on the European Social Agenda[67] talk of 'supporting initiatives linked to the social responsibility of undertakings' and supplementing 'Community legislation

[61] Council Decision 2002/177/EC of 18 February 2002 on guidelines for Member States' employment policies for the year 2002 [2002] OJ L60/60.
[62] *Ibid*, under heading III 'Encouraging adaptability of businesses and their employees'.
[63] *Ibid*, para 13.
[64] Para 14.
[65] Under the third specific guideline 'Address change and promote adaptability and mobility in the labour market' of Council Decision 2003/578/EC of 22 July 2003 on guidelines for the employment policies of the Member States [2003] OJ L197/13, 18.
[66] Under the fifth specific guideline 'Increase labour supply and promote active ageing' of Council Decision 2003/578/EC, *ibid*.
[67] Above n 37, heading II.

on working time' by finalising the provisions for the road transport sector and maritime and air transport.

When reviewing action taken under the adaptability pillar the Commission noted in its five year review of the Luxembourg strategy[68] that the main policy developments were related to 'more flexible types of employment relationships, and more flexible working time arrangements, in particular through annual reference periods of working time, thereby reducing overtime.'[69] This point is re-enforced in the Commission's background paper on 'Modernising Work Organisation'[70] that flexibilisation is achieved by means of changing reference periods of working time. It notes that the most important approach is the annualisation of the period over which the average duration of the working week is counted and that practically all Member States have reported an increase in this instrument.

However, the message coming from these various policy documents is mixed. Is the overall objective to reduce the hours worked by each person in employment with a view to creating jobs for others? This would be consistent with the Lisbon/Luxembourg goal of full employment. Or is the aim simply to reduce working hours to a 'safe' level? This would be consistent with the health and safety objective of the Working Time Directive. Or is the aim simply to enable workers to work the same number of hours, but as and when the employer demands it? This would be consistent with the flexibility agenda underpinning the adaptability pillar. In return for workers showing this flexibility, employers will become more competitive and this will ensure job security for workers. The lack of clear objectives has generated problems when it comes to implementing and applying the Working Time Directive.

The Implementation and Application of the Working Time Directive in the UK

The UK's Approach to Working Time Prior to the Directive

The UK has not enjoyed a tradition of central regulation of working time. Working time has been regulated by collective agreements generally negotiated at sectoral or plant level. These agreements have focused less on limiting working hours than on ensuring levels of overtime *premia*. Legislation on working time generally played a residual role — applying only to those

[68] Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions , 'Taking Stock of Five Years of the European Employment Strategy' COM (2002) 416 of 17 February 2002.
[69] *Ibid*, COM (2002) 416, 13.
[70] EMCO/28/060602/ENREV 1, 6.

sectors of the economy where collective bargaining had failed to develop, often in respect of vulnerable groups (mainly women and children) who were not covered by collective agreements. Much of this legislation was repealed in the 1980s, as part of the Conservative government's deregulatory agenda. This removal of state protection coincided with a decline in collective bargaining in many sectors.[71] What was left was a largely unregulated market, with a strong overtime culture dominating certain industries. For management, the use of overtime helped to achieve flexibility; for workers it provided valuable extra income.

The Working Time Directive therefore represented a significant cultural change in the UK and was met with considerable hostility in some quarters, in particular by the Conservative government which was in office when the directive was adopted. This helps to explain its unsuccessful challenge to the validity of the directive.[72] The implementation of the directive was eventually left to the Labour government which was more sympathetic to the aims of the legislation.[73] The relevant implementing measure, SI 1833/ 1998, closely followed the structure of the directive and largely adopted the 'copy-out' approach to implementation, with the UK taking full advantage of the transitional provisions and the derogations.[74] Nevertheless, certain sectors of the business community still considered that the regulation 'gold-plated' the directive. As a result, the government adopted the revised Working Time Regulations 1999, SI 1999/3372 (Regulations),[75] which were intended to 'relieve some of the administrative burdens imposed on employers.'[76] These regulations were intended to clarify the autonomous decision maker derogation and reduce the record keeping requirements.

The Effect of Implementing the Working Time Directive on Working Hours in the UK

The enactment of the Regulations raises the question as to the effect of the Working Time Directive on the working hours in the UK. Figures from 1988, when overtime working was at historically high levels, indicated that

[71] W Brown, S Deakin, D Nash and S Oxenbridge, 'The employment contract: from collective procedures to individual rights' (2000) 38 *British Journal of Industrial Relations* 611.
[72] See, eg the UK's unsuccessful challenge to the legality of the Working Time Directive, Case C-84/94 *UK v Council* [1996] ECR I-5755.
[73] See, eg The Fairness at Work White Paper, Cm 3968 which suggested that the regulation of working time was central to the government's family-friendly policies, as well as to a more productive workforce. It said 'There is no advantage to employers in exhausted employees. On the contrary, the need to work within fair maximum hours is likely to promote more efficient working practices and innovation' (para 5.6) and URN 98/465.
[74] C Barnard, 'Working Time in the UK' (1999) 29 *Industrial Law Journal* 61–75.
[75] C Barnard, 'Working Time Regulations 1999' (2000) 30 *Industrial Law Journal* 167.
[76] The regulations were further amended by SI 2001/3256 The Working Time (Amendment) Regulations 2001 to give effect to the Court of Justice's ruling in Case C-173/99 *The Queen v*

over 41 per cent of British male workers were employed for 46 hours or more per week, compared to 23 per cent for the EC as a whole.[77] Studies from this period also found that in some sectors, especially transport, hours worked were very long, regardless of cyclical factors.

Following the implementation of the Working Time Regulations little seems to have changed. A Trade Union Congress (TUC) study from February 2002,[78] based on analysis of the government's Labour Force Survey and a TUC-commissioned survey, reported that nearly 4 million people or 16 per cent of the labour force were now working over 48 hours per week compared to 3.3 million (then 15 per cent) in the early 1990s. It also found that the numbers working over 55 hours per week had risen to 1.5 million, that the average working week for the UK was 43.6 hours (compared to an EU-wide average of 40.3 hours) and that long hours were particularly prevalent among managerial and professional workers of both sexes, and among male workers in more highly skilled jobs in manufacturing, construction and transport. The main reason given by managers and professionals for working long hours was excessive workloads, while for manual workers it was the need to enhance earnings through overtime.

A joint Department of Trade and Industry (DTI) /*Management Today* study published in August 2002 reached similar conclusions. This survey found that 16 per cent of workers in 2002 were working more than 60 hours per week, by comparison to 12 per cent in 2000. Women workers employed for more than 60 hours per week had more than doubled from 6 per cent to 13 per cent in the same period. 75 per cent of all employees surveyed said that they worked overtime on a regular basis, but of these a third of this group said that they received overtime *premia* or time off in lieu. In addition, a DTI research note[79] reported in July 2002 that 16 per cent of all employees and 22 per cent of full-time employees were working over 48 hours per week in the spring of 2001. Three quarters of those working such long hours were men. Almost 9 per cent of full-time employees were working over 48 hours per week without receiving overtime.

These statistics therefore indicate that the Working Time Regulations have had virtually no impact on working time. However, there is some evidence that companies have used the Working Time Regulations as an opportunity to review working practices. This can be seen in Neathey and

Secretary of State for Trade and Industry, ex parte Broadcasting, Entertainment, Cinematographic and Theatre Union (BECTU) [2001] ECR I-4881.

[77] C Marsh, 'Hours of Work of Women and Men in Great Britain' *Equal Opportunities Commission Research Series* (London, HMSO, 1991).
[78] TUC 'About Time. A New Agenda for Shaping Working Hours' *Trades Union Congress* (London, 2002).
[79] S Hicks, 'Long Hours Working: A Summary of Analysis from the Labour Force Survey' *Department of Trade and Industry* (London, 2002).

Arrowsmith's 2001 study, carried out for the DTI, which was based on a non-random sample of 20 employers.[80] They found that around a third of the sample said that, as a result of the implementation of the Regulations, working practices had been reviewed with a view to putting in place a 'work smarter' strategy. Shorter working hours and/or the reduction of operating time to a reduced number of working days had led to greater flexibility of employment and, in some cases, improved operational efficiency and customer satisfaction. Around a third of the sample reported increased labour costs, and half reported increased awareness of the importance of working time from the perspective of health and safety issues.

On the other hand, half of the sample reported that the Regulations had had little or no impact on them: these tended to be smaller establishments, those making use of individual opt-outs and/or derogations established through collective agreements or workforce agreements, and those with working practices which were already in line with the Regulations. On the basis of their case study evidence, Neathey and Arrowsmith suggested that 'only in organizations which decided to use the WTR as the basis for a review of, and change to, existing working time practices, have the Regulations had any significant impact on the organization of working time', and in these organizations 'the absence of external pressure meant that the initial impetus for change diminished in the 18 months after implementation of the Regulations.'[81]

Our own research also revealed that some firms had taken advantage of the new rules to restructure working patterns in their companies. For example, the Health and Safety Executive (HSE) told us about one firm that did a cost exercise, employed additional staff and cut down overtime. It found that in the longer term it had actually saved money because it was not paying for the overtime. But, as the HSE acknowledged, this was far from the norm.

AMICUS[82] also provided two examples where union representatives and employers had jointly recognised the 'disadvantages in going along the long hours route [because] much of the overtime they were doing simply reflected low productivity.' In these particular companies issues had been resolved through negotiation and 'there has been a great deal of partnership and co-operation at the local level in improving productivity.' However, in general the union believed that manufacturing still suffered from 'the British disease of low productivity.' This, AMICUS argued,

[80] F Neathey and J Arrowsmith, 'Implementation of the Working Time Regulations' *Employment Market Analysis and Research series no. 11* (London, Department of Trade and Industry, 2001).
[81] *Ibid*, 72.
[82] Amicus-AEEU is the UK's largest manufacturing union with 730,000 members throughout the private and public sectors.

reflected a culture traditionally concerned with measuring inputs into the process rather than measuring outputs or outcomes. Typically a manager will be asked by his superior, 'how many [overtime] hours have you got in this week?' And if they have done a lot then the manager is praised rather than being condemned for not being able to do the work in the right time.

Some larger employers saw working time questions as part of the programme of corporate social responsibility. For example, one manufacturing and engineering company said:

> [Working time] is part of a wider responsibility which in our case is health and safety. We have been nominated number one company in the UK for health and safety. Also you can link CSR to job security and particularly for our kind of work where it is shop floor manual work, job security is the number one attraction. Obviously making sure people have an appropriate financial stability is another one. And making sure that people have a reasonable work situation whether that is in terms of facilities working hours etc. All those things need to be balanced. And to be honest working time flexibility is something that is very important to us. Some of our members say oh I wish I did not have to work overtime tonight. And we say you have got to look at the bigger picture. Overtime flexibility allows us to ride out the peaks and troughs and that in turn allows us to give you job security.[83]

But generally companies saw little connection between CSR and working time. This may be explained by a reluctance to embrace such language; or it maybe that working time is seen as a discrete area, divorced from wider issues of family friendly policies which more firms saw as part of CSR.

From this we can see that while for some firms the Working Time Regulations had a perturbating effect, generally these firms were the exception and not the rule. The TUC offered two reasons for this: the individual opt-out and 'a slack definition of working time that excluded many workers.' It is to this subject that we now turn.

The Role of the Individual Opt-out

The UK is currently the only Member State to take full advantage of the opt-out from the 48-hour working week although other states (eg Luxembourg, France and soon Germany, Netherlands and Spain) have used it in specific sectors. Our research suggests that the use of this opt-out has had a significant effect on neutering the effectiveness of the Working Time Regulations in securing the broader objectives envisaged by the Community. Instead of forcing companies to rethink their working patterns the majority have relied on the individual opt-out to maintain the status quo. A number of reasons have been offered for this. Most common is that the workers themselves

[83] Car manufacturer, interview on the phone 7 November 2002.

wanted to work the longer hours to improve their pay. According to the DTI, anecdotal evidence suggests that opt-outs are being used for:

> two main groups of people. These are the comparatively low, hourly paid workers who get overtime and also the comparatively highly paid management type people, [broadly defined], who do not get overtime but tend to have the sorts of jobs where they put in the hours that are required.[84]

So, overtime is not just an issue for the low-paid. As one manufacturing and engineering company, pointed out:

> [W]orking hours are inextricably linked to earnings … If you are asking me about the 48-hour week, in itself I would say it is a good thing. But, it is not that simple … I would like to see what they are going to say to the guy with the massive mortgage who is used to working massive hours … when his hours are reduced by 12 hours per week and there is nothing that he can do about it.[85]

Similarly, AMICUS gave an example of semi-skilled workers in the tobacco industry where 'if they applied the Working Time Directive they would lose £500 per week. That is their loss as that would be overtime.' AMICUS also provided the example of engineers working on offshore oil platforms. 'The guys believe they are offshore [and] their free time is meaningless to them, so they are going to work all the hours they can regardless of the effect it is going to have.' For these reasons, AMICUS believed that using opt-outs so as to maintain high levels of overtime was 'frankly a conspiracy between the worker and the employer.'

The importance of overtime to boost earnings was emphasised by the case of *Clark v. Pershore Group of Colleges*.[86] The applicant's contract of employment, which predated the Working Time Regulations, guaranteed him 19.5 hours overtime. This represented a substantial part of his income and was also important for his pension contributions. In compliance with their obligations under the Working Time Regulations, the college reduced his guaranteed overtime to 9 hours so that his working week did not exceed the 48-hour maximum. He refused to work under the new contract. This led to the bizarre result that he worked 48 hours a week but was paid for 58.25. The question was whether the employers (!) were acting in breach of the Regulations by insisting on compliance with the Regulations. Unsurprisingly, the tribunal rejected the claim. It pointed out that the 1998 Regulations were mandatory on both employer and employee and that they

[84] Interview in person 1 August 2002.
[85] Interview with large manufacturing and engineering company on 7 November 2002.
[86] *Clark v Pershore Group of Colleges*, Case Number 5203317/99.

applied unless both parties agreed to an opt-out. The tribunal concluded that the coming into force of the Regulations meant that the applicant's contract of employment was automatically varied by operation of law. Thus, his working hours could no longer exceed the limit laid down under the Regulations unless they were the subject of an opt-out agreement.

The extensive use of the opt-out was not simply because workers wanted to work the extra hours. Employers had reasons of their own for relying on the opt-out. Most important among them was cost. They argued that in the absence of the opt-out business costs would significantly increase because of the need to take on additional labour. This additional labour might also be less experienced. As one manufacturing and engineering company said: 'It is in our interest to have an experienced dedicated person on site for those hours, rather than be involved in the cost of getting someone else to do the work.' Even if employers did employ extra staff additional recruitment presented significant logistical problems and indirect costs. As another manufacturing and engineering firm explained:

> You [would] have to recruit more. You have then got all the lead-time of recruiting them and the skills problem. But, you have also got the logistics problem. Where do you put them? Where do you get the locker space? How do you fit them into the canteen? How do you physically accommodate all the extra cars in the car park? It sounds silly but these are all the things we have debated in the company.

Similarly, AMICUS provided the example of a company manufacturing heating and ventilation equipment where 'almost everyone is exceeding the 48 hours.' The company already ran a three-shift system so they would have required more plant if they were to employ more people.

Employers also expressed the concern that without the opt-out the additional costs on those UK firms involved in complying with the directive would prejudice the possibility of competing with foreign companies. For example, the EEF quoted the views of an unnamed domestic appliance manufacturer:

> If we have to increase our workforce and supply them with vehicles and equipment to make sure everyone always comes within the 48 hours, that is a significant cost to us which the consumer will have to bear and will make our products less competitive against foreign competition.

Other employers cited the problem of a skills shortage to explain why they could not comply with the 48-hour limit. For example, as one manufacturing and engineering firm said '[we] cannot recruit enough people locally, so we need people to work extra hours.' A construction firm expressed similar sentiments: given 'the current scarcity of operatives in the geo-technical and

civil engineering industry, from skilled operatives to qualified engineers, where will these extra bodies come from?' AMICUS agreed that 'the construction industry workforce is in high demand and the only way that you can get more work out is by working people longer because the workers simply are not there.'

Some employers justified their recourse to the opt-out to avoid industrial relations problems. The Engineering Employers' Federation (EEF), the Chartered Institute of Personnel Development (CIPD) and AMICUS all noted that the flexibility of the opt-out avoids potential disputes over the exact definition of what constitutes working time and what constitutes an autonomous decision maker for the purposes of the derogations. For these reasons, respondents to our study said that it was simply less risky and administratively easier to issue opt-outs, given the uncertainty of whether or not employees fell within the complex definition of an 'autonomous worker' in the 'unmeasured working time' derogation. For example, the EEF told us:

> It isn't seen for the senior managers as necessarily as attractive a way of going forward as the opt-out. I mean the unmeasured working time under the current arrangement, if you talk to companies, seems to be something that people move in and out of and therefore to actually monitor it is very difficult because they move in and out of the exemption. Therefore, if you were to do it properly you would have to track them a lot more than you would want to and some of their time can be unmeasured and some may not be and how are you going to start to record all this. Just in terms of administration it is easier to say too much trouble this, lets talk about opt-outs.[87]

So while the Directive itself provides alternatives to the opt-out, these have not been used largely because they are seen as complex and their scope is uncertain when compared with the simplicity of the opt-out. The difficulties of relying on the 'autonomous worker' provisions were also evident from the few cases the HSE had come across of firms relying on unmeasured working time derogation:

> People have classed work as unmeasured working time but it is quite rare I have found that it actually goes into that category because when it boils down to it they are required to do the work by the employers. The work they are given means they need to work these extra hours and if they don't do it there are implications. Therefore they are required to do it. It is not often that I come across the people who are doing all these extra hours because they want to.[88]

[87] Interview in person at their London offices, 14 August 2002.
[88] Interview on the telephone 30 July 2002.

The Role of the Social Partners

Identifying the Social Partners

Given that the existence of the opt-out has had such a detrimental effect on allowing the directive to be an instrument of change, to what extent have the social partners been able to rectify this and fulfil the role envisaged for them by the Luxembourg Guidelines and the European Social Agenda? As we have seen, the directive provides a significant role for the social partners. They have the power to implement the directive, flesh out its substance and derogate from certain provisions. In terms of the Lisbon/Luxembourg approach, the social partners are seen as the engines of the modernisation of working time. In the UK this has really not proved to be the case.

Using 'collective agreements and agreements between the two sides of industry at national or regional level' to implement, derogate or negotiate the content of the directive has long presented difficulties for the UK. The UK has been characterised by its 'single channel' approach to worker representation, with worker representation being dominated by trade unions.[89] This meant that in workplaces with no recognised trade unions workers had no collective voice. For this reason, the UK was condemned when in *Commission v UK*[90] the Court ruled that the UK had failed to fulfil its obligations under Articles 2 and 3 of Directive 75/129/EEC (now Directive 98/59/EC) on collective redundancies by not providing a mechanism for the designation of workers' representatives in an undertaking where the employer refused to recognise trade unions. This Court of Justice decision forced the UK to adopt a modified form of the single channel of worker representation, where worker representation is primarily conducted by recognised trade unions but, in the absence of such representation, workers can be represented by elected representatives who have negotiated a 'workforce agreement'.

This is the approach adopted in the case of working time. The directive was not implemented by the social partners but through legislation (a Statutory Instrument) adopted under the powers conferred by Section 2(2) of the European Communities Act 1972. The Regulations provide that a

[89] See generally P Davies, 'A Challenge to Single Channel' (1994) 23 *Industrial Law Journal* 272.

[90] Case C-383/92 *Commission v UK* [1994] ECR I-2479. The Court reached similar conclusions in Case C-382/92 *Commission v UK* [1994] ECRI-2435 in respect of Council Directive 77/187/EEC of 14 February 1977 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses [1977] OJ L61/27 (now Council Directive 2001/23/EC of 12 March 2001) on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses [2001] OJ L82/16.

collective agreement[91] or a workforce agreement may modify or exclude the application of certain regulations.[92] 'Workforce agreements', defined in Regulation 2(1) as 'an agreement between an employer and workers employed by him or their representatives in respect of which the conditions set out in Schedule 1 are satisfied',[93] are designed to provide a mechanism for employers to agree to working time arrangements with workers who do not have any terms and conditions set by collective agreement.[94]

Collective Agreements

Our research revealed that a number of companies had taken advantage of the possibility envisaged by the Regulations to use collective agreements to extend the reference period over which the 48 hour week is calculated, usually to six months, occasionally to a year. However, some continued to use the opt-out as a backup. For example, a construction firm which had negotiated a 26-week reference period and a food manufacturing company with a 12-month reference period still relied heavily on the opt-out, mainly so as to alleviate the administrative burden of recording and monitoring hours but also because there was still a risk of exceeding the 48-hour average even over the extended reference period. In fact, one of the operating subsidiaries of the food manufacturer had a standard shift pattern of 57.5 hours per week. Although overtime was paid for those hours worked above 39 hours per week, the overtime was not voluntary.

[91] Collective agreements are agreements defined in s 178 Trade Union and Labour Relations (Consolidation) Act (TULR(C)A1992) where the trade unions are independent within the meaning of s 5 TULR(C)A.

[92] The Working Time Regulations 1998, SI 1998/1833, Reg 23.

[93] These conditions are (sch 1, para 1):

(a) the agreement is in writing;

(b) it has effect for a specified period not exceeding five years;

(c) it applies either —

(i) to all of the relevant members of the workforce, or

(ii) to all of the relevant members of the workforce who belong to a particular group;

(d) the agreement is signed —

(i) in the case of an agreement of the kind referred to in sub-paragraph (c)(i), by the representatives of the workforce, and in the case of an agreement of the kind referred to in sub-paragraph (c)(ii) by the representatives of the group to which the agreement applies (excluding, in either case, any representative not a relevant member of the workforce on the date on which the agreement was first made available for signature), or

(ii) if the employer employed 20 or fewer workers on the date referred to in sub-paragraph (d)(i), either by the appropriate representatives in accordance with that sub-paragraph or by the majority of the workers employed by him;

(e) before the agreement was made available for signature, the employer provided all the workers to whom it was intended to apply on the date on which it came into effect with copies of the text of the agreement and such guidance as those workers might reasonably require in order to understand it fully.

[94] Above n 93, Sch 1, para 2.

Only the car manufacturer we interviewed had extended the reference period by collective agreement with the result that 'we are not relying on the opt-out as a way of running the business.'[95] Overtime flexibility was crucial to the company given the annual cycle of car sales and the high sales peak at the beginning of the model life of cars. The company noted

> So, ideally we want flexibility over a number of years, but as an absolute minimum we want flexibility within the year … anything less than [a] 12 months [reference period] is just unworkable for our kind of industry.[96]

The company had therefore negotiated a fixed 12-month reference, corresponding to the calendar year, so that overtime was managed on an annualised basis, although basic hours had not been annualised. In practice, this meant that the company had calculated that the regulatory 48-hour limit provided an overtime margin of 528 hours per year or 44 hours per month, after taking account of the basic 39-hour week and making adjustments for holidays. Overtime was then monitored on a monthly basis against the forecast for the year. If individual employers were nearing the ceiling of available overtime hours, management considered reallocating work or deleting work.

The TUC provided further examples of collective agreements being used to resolve issues of working practices. One concerned a major utility company that had made extensive use of individual opt-outs, especially for on-call engineers. Subsequently, this company had concluded an agreement that

> re-balances core hours and payments and overtime in a way that is going to significantly reduce average hours worked and it will be in the low forties, rather than in the low fifties. The employer has gained a move to 24 hour cover out of this, so that has been the quid pro quo.[97]

Another example concerned a dairy company faced with supplying supermarkets which expected demands to be met on time. Meeting the production targets set by the supermarkets led to working time of over 70 hours a week with the firm relying on the opt-out to achieve this. As a result of the collective agreement, the company went to 52 week working, to annualised hours, and to different shift patterns. They gave employees their choice of working a number of different shift patterns, based on 40, 42, 44, 46 or 48 hours a week. By doing that they managed to produce the same amount of milk on time. This led to some loss of earnings but not a complete pro rata

[95] Interview on the telephone 7 November 2002.
[96] *Ibid.*
[97] Interview in persons at Congress House, 25 July 2002.

loss of earnings and there was some compensation. The TUC argued that these were examples of:

> [N]egotiating in the shadow of the law … they think the opt-out is going to go, they believe they are preparing for the inevitable, and they would rather do it without there being excessive time pressure imposed on them.[98]

However, collectively agreed work practices seem to be the exception rather than the rule. The TUC recognised that the failure to address the issue of work patterns was as much due to the reluctance of unions as it was a failing of employers:

> While I think it is fair to say that more employers are starting to think about these issues, it is still the case, I would say, that most employers who have a problem have not yet got to grips with it. Just as most unions who have a problem, have not got to grips with it.

While the TUC is committed to removing the opt-out, it accepted that there was a certain 'rhetoric-reality gap' in the trade union movement. It said that working time 'is not quite as high on the bargaining agenda as it might be, and where it is, there is not enough progress being made.'[99] It added that unions had found it difficult to make progress on the issue voluntarily because, they find it very hard to say to their members, 'we are going to be taking money out of your pockets.' It is because people cannot see how a different pattern of pay and hours can be agreed and therefore when it is presented to them they say, 'no, we are not having it, we don't want you to talk about that.' Therefore, the TUC argued that rather than the opt-out being necessary for British business, it had in fact reduced the incentive for employers and unions to negotiate about reorganising working practices.

Our research therefore indicates that while, in some companies, collective agreements have provided a way of trying to balance flexibility and security in respect of working time, even in unionised workforces this has not always been a priority matter. And unionised workforces are now in the minority: figures from the DTI indicate that only 29.1 per cent of UK employees are union members and only 22 per cent of employees in the private sector are covered by collective agreements.[100] This lack of infrastructure or mechanisms in the UK raises the question of whether 'workforce agreements' can provide a feasible alternative to using individual opt-out agreements in non-unionised UK workplaces.

[98] *Ibid*.
[99] *Ibid*.
[100] K Brook, 'Trade Union Membership: an analysis of data from the Autumn 2001 Labour Force Survey' (2002) Department of Trade and Industry <http://www.dti.gov.uk/er/emar/artic_01.pdf.> (27 August 2003). 73% of public sector employees are covered by Collective Agreements.

Workforce Agreements

The evidence suggests that workforce agreements have also been only rarely used to date. Out of twenty case studies in the empirical study by Neathey and Arrowsmith, three organisations (a housing association, a finance company and a hospitality company) had implemented a workforce agreement.[101] This actually seems on the high side when compared to other surveys. For example, an Institute of Personnel and Development survey found that 56 per cent of respondents were aware of the concept of workforce agreements, but only 18 per cent had introduced, or were thinking of introducing such agreements in the workplace.[102] Similarly, the Advisory, Arbitration and Conciliation Service (ACAS) informed us that they had 'not got evidence of lots of them' and only one member of the EEF had reported that they had implemented a workforce agreement.[103]

Two reasons emerged as to why workforce agreements are so rarely used. The first concerned the complexity of the process. The CBI said that employers felt the procedure was 'off-putting'. The EEF agreed. It said that it knew of one company where the complexity of the workforce agreement route had persuaded an employer to issue individual opt-outs instead:

> I can remember one organisation with a lot of service engineers. We went to quite a lot of trouble to draft a workforce agreement and explain how they went about the process and they were just in the end too daunted. When you explained to them what they had got to do to get a workforce agreement their hearts sank. … [Their response was,] 'Get them to sign an opt-out. That is an easier way. We could have dealt with it by an averaging but that's far too difficult that nonsense.'[104]

The second reason was that workforce agreements were perceived as not sitting easily with the cultural experience of the UK. The employment lawyer put it this way:

> [Employers] would not want to be seen to be negotiating these things because you know once you start negotiating with your workforce about these sorts of issues, which is a sort of working hours issues, the classic collective bargaining issue, it encourages people to start wanting to negotiate on other things as well. So, I think the employers have steered clear of it. So, it is not the normal way. It does fit rather better into the Continental way of doing things.[105]

[101] Above n 75, 15.
[102] IPD 'The Impact of the Working Time Regulations on UK plc' (London, Institute for Personnel Development, 1999) 8.
[103] The company was not willing to participate in the study.
[104] Interview at EEF offices, 14 August 2002.
[105] Interview over the telephone 13 November 2002.

This was also the main reason given by the CBI to explain the reluctance of UK employers to enter into workforce agreements. 'It is cultural and it is a visceral response. Do we really want to be going down that route?' They are just not happy with that approach. They don't think it is how they want to be relating to their employees.'

So, all this explains why ACAS had found that, 'generally what we have got is people making individual opt-outs in non-unionised organisations and in unionised organisations the collective bargaining mechanisms have taken account of it.'[106] Of course, this raises the question of whether or not structures for employee representation, and more workforce agreements, would evolve in non-unionised firms if the individual opt-out was removed and employers had no choice. The employment law practitioner did not believe that this would necessarily be the case:

> If the opt-out was not available then people would be more interested because they would be forced to be interested … but I do not think it would stimulate the wholesale use of workforce agreements … . Almost none of the employers that I deal with on a regular basis would have the stomach for it or the institutions already in place to create one. But, they may take off in future years because of the Information and Consultation Directive coming into force … in March 2005. I think people may well start to set up planning bodies with whom workforce agreements could be negotiated.[107]

Enforcement

We turn now to consider the question of enforcement. We have seen how enforcement of existing health and safety legislation is an important strand of the modernisation agenda. How has this played out in the UK in respect of such high profile subject matter? The distinction found in the Working Time Directive between *limits* on working time and *entitlements* to rest is reflected in the British approach to enforcement. In essence, limits are enforced through criminal sanctions against the employer by the Health and Safety Executive (HSE) and local authority Environmental Health Departments, entitlements through civil action in an Employment Tribunal. In practice there has been little pro-active enforcement of the Working Time Regulations.[108] To our knowledge there has been only one prosecution in the UK as a whole for a breach of the working time limits in *Breckland*

[106] Interview over the telephone 13 September 2002.
[107] Interview over the telephone 13 November 2002.
[108] See also the practice of Carlisle City Council in *Watson v Swallow Hotels* Case 6402399/99, Carlisle Employment Tribunal.

District Council v Fourbouys Ltd. The case concerned the manager of a newsagent, Mrs Lumbard, who was working on average 71 hours per week, but had not signed an opt-out form. The council prosecuted her employer because the facts were 'so extreme and so serious' (this situation had been going on for over a year despite Mrs Lumbard complaining to her employers on several occasions) and because there was sufficient evidence to bring the case (Mrs Lumbard had kept all the necessary paperwork). Magistrates fined Forbouys £5000 with £2150 costs and ordered the company to pay Mrs Lumbard £1200 compensation.[109]

However, generally Breckland DC, in common with most councils, does not follow the prosecution route.[110] Instead, they advise employers of the requirements of the Working Time Regulations and expect them to follow the advice. This practice is consistent with the HSE's general policy in all health and safety matters to prosecute as a last resort. While the HSE's Working Time Officer who was interviewed was upbeat about general levels of compliance, the local authority Environmental Health Inspector offered a rather different view. He said that working time was not seen as a priority area. Only if a general health and safety inspection also revealed a working time problem would they look into working time more carefully.

Only two of the case study employers had had any contact with enforcement officers. One hotel and catering company said that they had been inspected by the HSE following a complaint by a member of their retail staff about excessive working hours. From recollection, the HR manger did not think an opt-out was involved. The company said that, after checking records, the HSE had decided that it was not a case of excessive hours. By contrast, one of the operating subsidiaries of the food manufacturer interviewed had actually been issued with an improvement order on working time after an HSE inspection.

Perhaps surprisingly, some of the case study employers were critical of what they perceived to be a lack of enforcement of the Regulations. One manufacturing and engineering firm, while not necessarily advocating greater enforcement, questioned the efficacy of the legislation if it was not enforced properly:

> We responded because we are a responsible employer. There are probably loads of firms out there who just ignore it. But nobody is doing anything about them because there is no policing of it. So why have it?[111]

[109] I Cockayne and M Gostelow, 'Woman worked 97 hours in week' Eastern Daily Press (Norwich, UK Country, August 2002) 1.
[110] Interview with anonymous Health and Safety Manager, Breckland District Council (Telephone, 5 November 2002).
[111] Interview over the telephone, 4 September 2002.

However, two employers did call for greater enforcement of the Regulations. A manufacturing and engineering firm argued that:

> Big players like us in the service industry in the UK play by the rules. You get down to the smaller companies and they do what they want. But, we will lose business in some areas to those that will ignore the rules and will go ahead and do what they want in any event and regretfully get away with it. At the end of the day I would like to see a level playing field.[112]

On the other hand, ACAS felt that employers generally would not like to see the Regulations enforced more robustly, a view echoed in the strongest terms by a hotel and catering company.[113] However, ACAS acknowledged that even if there was a greater will for more pro-active enforcement:

> [The HSE] had no resources really to fulfill their obligations under these regulations and therefore they have not been in a position to go policing it in a way that would perhaps have been envisaged and preferred. And as soon as employers realise that then, without seeming too cynical, obviously they relax.

In response, the HSE said:

> All I can say on that is when the legislation was first introduced obviously HSE was tasked through DTI to carry out enforcement. The work was looked at and the resources and it was decided that seven working time officers [for the UK as a whole] was sufficient and the role is basically to provide advice and guidance either written or verbal and we work only on a reactive basis. It is not a proactive role. It is reactive on the basis that if we get a complaint we investigate it. That is the way the DTI and HSE decided to resource it.[114]

That said, there was evidence of practical failings on the part of the HSE. For example, UNIFI[115] said that where it contacted the HSE because it was concerned about excessive working hours in the regulated sales teams of a major retail bank:

> I got through to the Health and Safety Executive and left messages specifically for the Working Time Regulations people, saying 'we are desperate, we need your help', and they did not get into contact with us. I phoned them twice and they did not return my calls. I am furious.[116]

[112] Completed a questionnaire on file with the author.
[113] Interview over the telephone, 18 September 2002.
[114] Interview 13 September 2002.
[115] UNIFI is the largest trade union specialising in the finance sector, with 158,000 members, working for over 400 employers.
[116] Interview over the telephone 31 July 2002.

AMICUS believed that the failings of the HSE were due in part to the context in which the Working Time Directive had been implemented in the UK:

> Almost alone of the unions we have argued from the beginning that this was a health and safety issue and not a terms and conditions issue … Neither the regulations or the guidance are written in the context of it being a health and safety issue … [HSE inspectors] are not prepared to do anything about it [because] they do not like getting involved in anything that is even remotely involved with terms and conditions of employment. … [So,] the biggest problem of all with these regulations is that they are seen as terms and conditions issues not as health and safety issues.[117]

Given that the scheme for enforcing the Regulations depended on action by agencies such as the HSE and local authorities, this left individual workers powerless to enforce working time limits unless they terminated their contract. In a surprise move, the High Court in *Barber v RJB Mining*[118] filled the lacuna in the regulatory scheme by providing individuals who wanted to enforce the limits without wishing to terminate their contract, with a contractual claim. Gage J said:

> It seems to me clear that Parliament intended that all contracts of employment should be read so as to provide that an employee should work no more than an average of 48 hours in any week during the reference period. In my judgment this is a mandatory requirement which must apply to all contracts of employment.

Our research therefore suggests that the lack of enforcement of these regulations is a serious issue. The lack of prosecutions in itself does not mean that the Regulations are not being enforced at all because the co-operative approach, with prosecutions as a last resort, is characteristic of health and safety enforcement in the UK. More serious is the growing *perception* that health and safety inspectors are not interested in working time issues and that starts to create a culture of disregard of the Regulations.

CONCLUSIONS

The Working Time Directive is essentially an old-style directive which is intended to achieve new-style objectives which themselves are not clearly defined by a Directive whose provisions are themselves lacking in clarity.

[117] Interview over the telephone, 14 November 2002.
[118] *Barber v RJB Mining* [1999] IRLR 308.

As an experiment in multilevel governance it has not been a great success. The UK government has implemented the rules, but without much enthusiasm. The social partners, particularly the unions in head office, have faced an uphill task in persuading local level branches and their members to take the reform agenda seriously. Largely, the workers and the employers have worked together to avoid any reform agenda by relying so extensively on the opt-out. This has led to the result that the opt-out, introduced in the name of securing flexibility, both politically and economically, has served to create a barrier to reform. These problems are exacerbated by a lack of enforcement and a perception that the authorities themselves are not committed to the reform of working time.

The failure of the Working Time Regulations to achieve the Luxembourg and Lisbon objectives may also be due to the lack of clarity of those objectives, to insufficient communication by the EU of those objectives and to insufficient reinforcement of that message by the UK government. What is clear is that at present, as far as working time is concerned, the Luxembourg and Lisbon agendas remain firmly rooted abroad; they have not penetrated the shop floors in London or Liverpool. It seems that much energy has been devoted to (legally) circumventing the rules because the rules do not coincide with the values of both employers and workers. Where EC social rules have coincided with national values — such as equality in pension and retirement age — then the rules have been readily embraced (and enforced) by employees and this has done much to legitimise the EU in the eyes of its citizens. Where employees and their representatives have not taken these rules on board, this has brought the European social model into disrepute. This is the key message for the EU as it seeks to accommodate the interests of an ever larger number of highly diverse states. As Csilla Lehoczky explains in her chapter in this collection, because trade unions — so central to the reform agenda — are seen as pillars of the old regime they are discredited in the eyes of many workers in those (predominantly public sector) companies where they still exist; and the new forms of worker representation envisaged by the various worker consultation directives have yet to take root. This, combined with weak enforcement machinery, means that the Lisbon agenda risks falling on even stonier ground in the accession states.

References

Barnard, C (1999) 'Working Time in the UK' 29 *Industrial Law Journal* 61.
—— (2000) 'Flexibility and social policy' in G De Búrca and J Scott (eds), *Constitutional Change in the EU: From Uniformity to Flexibility?* (Oxford, Hart Publishing).
—— (2000) 'Working Time Regulations 1999' 30 *Industrial Law Journal* 167.

Barnard, C and Deakin, S (2002) '"Negative" and "Positive" Harmonisation of Labor Law in the European Union' 8 *The Columbia Journal of European Law* 389.

—— (2002) 'Corporate Governance, European Governance and the Role of Social Rights' in B Hepple (ed), *Social and Labour Rights in a Global Context: International and Comparative Perspectives* (Cambridge, Cambridge University Press).

Bercusson, B (1993) 'Working Time in Britain: Towards a European Model' *Part I Institute of Employment Rights* 4.

Biagi, M (1998) 'The Implementation of the Amsterdam Treaty with Regard to Employment: Coordination or Convergence?' 14 *International Journal of Comparative Labour Law and Industrial Relations* 325.

Brook, K (2002) 'Trade Union Membership: an analysis of data from the Autumn 2001 Labour Force Survey' Department of Trade and Industry.

Brown, W, Deakin, S, Nash, D and Oxenbridge, S (2000) 'The employment contract: from collective procedures to individual rights' 38 *British Journal of Industrial Relations* 611.

Cockayne, I and Gostelow, M (2002) 'Woman worked 97 hours in week' *Eastern Daily Press* (Norwich, UK, 12 August 2002).

Davies, P (1994) 'A Challenge to Single Channel' 23 *Industrial Law Journal* 272.

Freedland, M (1996) 'Employment Policy' in P Davies, A Lyon-Caen, S Sciarra and S Simitis (eds), *European Community Labour Law: Principles and Perspectives (Liber Amicorum Lord Wedderburn of Charlton)* (Oxford, Clarendon).

Hicks, S (2002) 'Long Hours Working: A Summary of Analysis from the Labour Force Survey' Department of Trade and Industry (London).

Marsh, C (1991) 'Hours of Work of Women and Men in Great Britain' Equal Opportunities Commission Research Series (HMSO, London).

Mosher, J and Trubek, D (2003) 'EU Social Policy and the European Employment Strategy' 41 *Journal of Common Market Studies* 63.

Neathey, F and Arrowsmith, J (2001) 'Implementation of the Working Time Regulations' Employment Market Analysis and Research series no 11 (Department of Trade and Industry, London).

Sciarra, S (2000) 'Integration through Coordination: The Employment Title in the Amsterdam Treaty' 6 *Columbia Journal of European Law* 209.

Scott, J and Trubek, D (2002) 'Mind the Gap: Law and New Approaches to Governance in the European Union' 8 *European Law Journal* 1.

Trade Union Congress (2002) 'About Time. A New Agenda for Shaping Working Hours' Trade Union Congress (London).

8

*European Enlargement: A Comparative View of Hungarian Labour Law**

CSILLA KOLLONAY LEHOCZKY

INTRODUCTION

THROUGHOUT THE LAST few years, the Central East European candidate countries have been consumed with the question: 'What will EU accession bring us?' This question has echoed across the continent, through media, conferences and meetings, permeating even private conversations. On the other side of the slowly opening door, the same question might be asked — probably with somewhat more concern and reservations — 'What will the [Eastern] enlargement bring us?'

This chapter attempts to outline the answer to these questions in the field of labour and employment law. For the most part, the paper draws on the Hungarian experience. But it also looks at the whole region. This strategy is motivated by the conviction that in labour law the answer to the first question determines and implies the answer to the second one: the impact of the accession process on the labour laws of the candidate countries will greatly influence the 'contribution' of these countries to the development of labour law in the EU in the coming years.

The chapter is organised as follows: Section I of this chapter summarises the processes that started with the revolutionary changes at the turn of the 1990s. The analysis emphasises the repercussion effect of the political and economic changes on the labour market and labour regulation that have been decisive factors for the post-1989 developments. Section II surveys Hungarian legislative changes and discusses their role in redesigning labour

* 'Labour law' in this chapter means both individual employment law and collective labour law in line with the use of the term common in Europe. This is different from the American terminology that applies to the body of law relating to trade unions, collective bargaining and collective disputes.

law. The survey will compare the initial conditions of the ex-socialist labour law with existing EU law. Section III is dedicated to the transformation of the industrial relations system, at least to the extent that it is relevant for the post-enlargement period, when the 'two lungs of Europe' join again.[1] Section IV summarises the main factors that determine how enlargement will impact on the new Member States and outlines alternative trajectories, the realisation of which will largely depend on developments in the EU.

THE EFFECTS OF POLITICAL AND ECONOMIC SHIFTS IN EMPLOYMENT AND THE LABOUR MARKET

The Repercussions of the Past and the Lack of Stable Values

After the political shift to multi-party democracy and the initiation of economic change in the post-communist countries, employees were the first large social group to feel the pressures of the newborn 'market economy' — immature and disproportionate as newborns tend to be. In Hungary, workers had been exposed to the pressures of the market place already prior to the political transformation. The so-called 'spontaneous' privatisation and 'new-entrepreneurship'[2] foreshadowed the future trend that workers would be among the losers of the changes. Their losses had already begun to manifest themselves when the first experiences with freedom and liberty were filling the political atmosphere with hope, excitement and enthusiasm.

The liberation from several decades of oppression was superseded by a reaction that uncritically approved everything that was the opposite of the past and of its imposed values. This allergic response to anything that resembled the institutions of the past appeared in almost all social fields,[3] but it was particularly intense in economic, employment and labour law since these areas of the law had been at the core of the ideology and foundation of

[1] See 'Speech of His Holiness Pope John Paul II in reply to the New Year greetings of the diplomatic corps accredited to the Holy See' (11 January 1999) *Catholic Information Network* <http://www.cin.org/jp2/jp990111.html> (11 September 2003).

[2] The term spontaneous privatisation refers to the privatisation of state enterprises and other state owned assets prior to the regulated privatisation programme. The process was characterised by courageous experiments to resuscitate wasteful enterprises, but also by blatant robbery, amounting to the expropriation of state property by individuals in economic or political power at that time. The new owners — frequently from the ranks of the *cadres* of the previous regime — unconsciously or knowingly — mirrored the Marxian description of 'capitalist exploiters', which they were only too familiar with.

[3] To give a few examples: Russian language and culture as such became almost discredited because it previously had been imposed upon the country; as a reaction to forced 'communist internationalism' and oppression of national feelings, extreme nationalism and chauvinism could appear as patriotism; extremist political figures, in some cases true criminals, were cast in a positive light or even featured as martyrs and heroes merely because they had been mistreated by the communist dictatorship, etc.

the fallen regime. Collectives and collectivity had been glorified — now radical individualism was favoured. Freedom had been oppressed and paternalist protection had prevailed — now *laissez faire* became the new mantra. Enterprises had to deal with trade union *cadres* at every step and about every detail of the workplace — now employers were to be freed from any intervention, even from participation by other stakeholders.

If, in the ideology of communism, private property and market freedom had been painted black and identified with unscrupulousness and exploitation, the '*a contrario*' logic painted the market economy white, as a pure attribute of freedom and private property, something that was to be encouraged in the new regime. The absence of well established values and theoretical groundings for the massive socio-economic changes meant that unscrupulous behaviour and exploitation were frequently confused with freedom and entrepreneurship, while employee protection and restraints on employers' freedom to manage labour resources were condemned as inefficient communist style imposition.

Restoration of Contractual Freedom

In this atmosphere, the required transformation of labour legislation from a 'socialist labour law' to a market-oriented one was expected to give greater weight to entrepreneurial freedom and to the contractual freedom of the parties: a 'return from status to contract.'[4]

Socialist employment law conferred a status on employers rather than creating a contractual relationship based on negotiations and agreements of the parties. The rights and duties of people — inside and outside the workplace — were tied to the status coined in the socialist slogan of the 'worker taking part in building up socialism'. To be sure, workers in all Central and Eastern European (CEE) countries were employed pursuant to a 'labour contract', which served primarily administrative purposes. The conditions of employment were regulated in great detail by centrally set laws, leaving only little room for the parties to negotiate.

Beyond the formal contract the actual labour relationship resembled an administrative-hierarchical affiliation. The flip side of the well protected status of the employee was her subordination not unlike the hierarchical relationship between a ruler and his subject, but in contrast to a horizontal relationship among private parties. The lack of a genuine contractual relationship was reflected in the employer's broad powers to unilaterally modify

[4] Henry Sumner Maines in his Ancient Law (New York, Dutton, 1917), of course, coined the term from 'status to contract'. The socialist system may be said to have reversed this trend, and the post-socialist transition has returned these countries now to the earlier point of departure, the evolution from status to contract.

the contract on highly ambiguous grounds, such as the 'collective interest'. The strong subordination of the employee to the unilateral power of the employer was supposed to be balanced by extensive forms of representative participation, in particular by the extensive rights of trade union officials to take part in managerial decision-making. In fact, trade unions did little more than rubberstamp decisions that had been taken elsewhere. While this added to the length and bureaucratisation of decision making processes, it did not effectively protect employees. Economic reforms launched in Hungary as early as 1967–1968[5] resulted in some decentralisation as the existence of separate interests was cautiously acknowledged. Still, the subordination of employees was not fundamentally altered.

After the fall of the communist regime, the quest to restore the freedom of contract in labour relations was an immediate, and arguably an inevitable response. It was claimed that centrally set wages had prevented pay differentiation as a means to reward performance. The socialist system had thus supported mediocre and unproductive labour. Liberalisation and greater contractual freedom, including income differentials were deemed to cure these deficiencies — a proposition that went unquestioned by both sides in the labour relationship.[6] The demand to re-contractualise, ie to transform labour relations back into contractual relations, went far beyond the mere abolition of a centralised wage system. Freedom of contract was considered identical with the abolition of nearly all restrictions on the freedom of the entrepreneur to hire, fire and utilise (in fact, to exploit) its labour force at will.

Public discourse focused on how to 'reintegrate' labour law into civil law and to regulate employment within the context of contract law.[7] However, legislative initiatives were dampened during the early transition period by political considerations, partly because of the emergence of a functioning tripartism that resulted in compromised legislative proposals, reflecting not only the government's but also the trade unions' views.[8] In Hungary, the

[5] Hungary started its economic reforms first in 1967–68. However, for political reasons the reforms could not address the core of the system, ie state property and central economic planning. More far-reaching economic reforms that questioned the basis of the socialist regime were undertaken only in the late 1980s.

[6] See J Kornai, *Economics of Shortage* (Amsterdam, North Holland, 1980) 306–9 on 'soft budget constraint' of the planned economy that, among other 'shortages', created labour scarcity and competition among state-companies for workers, by way of wage increases and various fringe benefits. This, in return, prompted the state to set more and more detailed central regulations on wages and benefits. Not surprisingly, the marginal group of private employers could offer much better wages and therefore working for a private entrepreneur was considered a desirable form of employment, in spite of the harder conditions.

[7] J Radnay, 'A munkajog és a polgári jog kapcsolata' (The relationship between labour law and civil law) in *Liber Amicorum for Janos Zlinszky* (Miskolc, Miskolc University of Sciences, 1998) 242–48.

[8] L Héthy, 'Political Changes and the Transformation of Industrial Relations in Hungary' in JR Niland, RD Lansbury, and C Verevis (eds), *The Future of Industrial Relations. Global Change and Challenge* (Thousand Oaks, Sage, 1994). For the presence of political considerations in

new Labour Code of 1992[9] (Labour Code) introduced numerous changes aimed at bringing labour legislation in line with the requirements of a market based economy and to eliminate its administrative character. It changed the system with respect to termination in two important ways. First, the previously existing long list of socially indicated limitations and prohibitions on termination was radically cut. Only few restrictions remained, at least for employees in the private sector.[10] Second, financial compensation for the loss of a job — a remedy unknown under the previous regime — was introduced. Mandatory redundancy (after layoff) payments — provided that the threshold of at least three years of employment was met — became available. Fixed term employment contracts could be 'bought off' prematurely by payment of lost wages. Finally, financial compensation became available as a remedy for unlawful termination in lieu of reinstatement.

Another significant step in Hungary's process to re-contractualise employment was the replacement of formerly binding legal rules with broad principles and opt-out clauses that were designed to protect employees. Thus, unless explicitly provided to the contrary by the Labour Code, parties may depart from its norms by agreement. However, only agreements that favour the employee are permissible. In effect, the Labour Code established minimum standards of employment.

Although the new norms emphasised the equality of the contracting parties, in practice they conferred substantial powers upon employers. The legacy of administrative subordination in the previous regime had cast its shadow. Management could rely on the lack of employees' 'citizenship', on the principle that 'everything is permitted that is not prohibited'[11], and on a general public tolerance for stretching, if not outright evading or even violating legal rules to advance their own interests. The imbalance of power created an early 19th century atmosphere at the workplace throughout the country, but especially in regions that were particularly hard hit by unemployment.

In addition, the re-contractualisation of labour relations allowed entrepreneurs to use legal devices to opt-out of the labour protection provisions that had remained. A common strategy was for the previous employee to establish a front business entity, partnership or corporation that would contract for the delivery of services with the previous employer. Workers participated in these ventures as partners rather than being hired as employees, and thus

other countries see for example K Ribarova, 'Bulgarian transition and employment relations' (2002) 4 *South East European Review*, esp 27, 36.

[9] The Hungarian Labour Code, Act XXII of 1992. *Törvények és rendeletek Hivatalos Gyujteménye [Official Bulletin of Laws and Decrees]* 1993 (Budapest, Közgazdasági és Jogi Kiadó), 52–73.

[10] A longer list of protected situations remained in force as to public employees.

[11] As a reaction to the past rule of 'Everything is prohibited that is not [explicitly] permitted.'

participated fully in the risk of the undertaking. While similar strategies are known elsewhere, the impact was particularly severe in Hungary and other transition economies because of the extremely weak position labour found itself in after the collapse of the socialist system. In CEE, the formerly dependent employees had to adjust virtually overnight to an environment that favoured initiative, risk taking and lacked the protections of the workplace they had been accustomed to.

The reaction of consecutive governments to the hardships produced by these changes was typical for the region and manifested path dependence[12] of old habits. The Hungarian government intervened through legislation, adopting a series of ultimately ineffective placebo norms. At times, the government reverted to state paternalism, adopting norms that in fact were inconsistent with the new economic regime. A good example for the first strategy is the recent amendment of the Labour Code.[13] The code defines the concept of the labour contract and prohibits the use of a legal form that differs in substance from the labour law relationship. However, it seems naïve to suggest that such a provision would empower workers, intimidated as they are, to take recourse to the overloaded courts. Nor does such a broad provision ease the task of labour inspectors,[14] which are overburdened and understaffed, to enforce the prohibition more effectively. Thus, while the new provision in the code might look nice for political purposes, it amounts to little more than a placebo norm.

THE ACQUIS AND THE IMPACT OF HARMONISATION ON HUNGARIAN LABOUR LAW

The Specific Characteristics of Labour Law Approximation

In light of the above analysis, which depicted the situation in Hungary as oscillating between the norms of the past and the not fully established standards of the future, it could be argued that the mandate to comply with the obligation of European harmonisation would have a 'mediating' or 'settling' effect on CEE countries. In this optimistic vision, the European path might help these countries find their own way between the extremes of American

[12] D North, *Institutions, Institutional Change, and Economic Performance* (Cambridge, Cambridge University Press, 1990) at 93. Path dependence is explained by North as follows: 'But if the process by which we arrive at today's institutions is relevant and constrains future choices, then not only does history matter but persistent poor performance and long-run divergent patterns for development stem from a common source.'

[13] The Hungarian Labour Code, Art 75/A (effective as of 1 July 2003) above n 9.

[14] In order to supervise and inspect the observation of rules on labour safety and hygiene and of fundamental labour rights (ie the right to wage, equal treatment, working time, etc) a Chief Labour and Labour Protection Inspectorate has been created, to monitor compliance through local inspectorates.

style neo-liberalism and East European style 'neo-socialist' solutions, towards a market economy with sound social protection.

Between 1991 and 1996, all the candidate countries signed and ratified the so-called 'Europe Agreements.' Pursuant to the agreements, these countries became associated with the Union, receiving the 'associate member' status and committing themselves to approximating their legislation to the *acquis communautaire (AC)*. Among the first ones, Hungary signed the Association Agreement in 1991, starting the transplantation process.

In the context of the EU, labour law harmonisation has been a controversial process, more so than other areas of the law, which is largely due to its highly political nature. Corporate law, consumer protection, taxes, customs and competition law form the core of the traditional harmonisation project aimed at establishing a common market. These bodies of law were for the most part non-existent in the former socialist countries. By contrast, labour law had been at the heart of the fallen regimes of the working class. Yet within 'old' Member States, labour law harmonisation was merely a side show. Attempts to regulate labour protection at the European level were at best 'tolerated', but not 'supported'. The few exceptions are the principles of equal pay and occupational health and safety. Regulation at the European level of some core aspects of labour law, including the terms of labour contracts, the rights of trade unions, collective agreement and collective action are forestalled by the subsidiarity principle.[15]

In certain respects, the level of social protection of workers was higher in the new Member States than in the old ones. This is the case, for example, with regard to job security, social benefits received from employment, as well as the generous regulation of leaves of absence, vacations and working time. Given these starting conditions, it was to be expected that the adoption of the AC would not strengthen the standards in the new Member States — as was arguably the case in other areas of business law. Instead, the adoption of the AC contributed to the decrease of existing levels of protection. Paradoxically, the older Member States feared the effects of social policy dumping in the acceding countries, as this could potentially fuel migration. However, they have guarded against such developments by derogating from one of the four freedoms, the free movement of persons, for the time being.[16]

[15] See Art 5 TEU.

[16] The free movement of persons was postponed for two years, after which states may revise the postponement and may maintain it for another three years, and if necessary, for a further two years. After seven years no more prolongation is possible. The complicated regulation of the derogation from the free movement of persons (differentiated according to Member States, accession states and kinds of activity to be pursued in a Member State) is to be found in the Annexes (for each accession country) annexed to the 'Act of Accession' attached to the 'Treaty of Accession', [2003] OJ L236/46, for Hungary Annex X.

Although the concerns of the 'old' and 'new' Member States seem to contradict each other, both are justified. The contradiction lies in and can be explained by the character of the labour laws of the post-socialist countries, which resembles a patchwork of paternalistic, state-socialist and 19th century style regulation of worker relations. While the laws inherited from state socialism were more generous to workers than the European standards as embodied in the AC, high levels of job protection in the old regime went hand in hand with low wages and poor material conditions. The liberalisation of labour relations chipped away at labour protection exactly where it had been strongest. Job security has decreased dramatically placing workers in a position of employees 'at will'. So far, this trend has not been compensated by wage increases to levels seen in other market economies. Moreover, this trend has raised fears, especially among trade unions in the acceding countries, that these countries served as a Trojan horse to import American liberalism into the European social model.[17]

Adopting the parts of the AC that are relevant to labour law has created the need for developing new institutions on the one hand, and changing existing rules and institutions, on the other. The following two sections will deal with each one of them in turn.

Developing New Institutions: Company Restructuring

Protecting the rights of employees in the process of company restructuring — transfer, group dismissals and insolvency — has no precedent in socialist labour law. These events are typical for a market economy, but do not exist in a centrally planned economy. Thus, the three directives to be discussed below[18] were as new to the former socialist countries as company law, competition law, consumer protection law, etc.

The institutional changes witnessed by Hungary and other former socialist countries can be characterised as follows. First, the past regime offers little by way of precedence. Labour protection was built into the socialist system, whereas there was little need for the complex set of labour protective institutions seen in the social market economies of Western Europe. Second, the

[17] The popular EU metaphor of 'Trojan horse' for the creeping American influence, this time in the context of industrial and labour relations is borrowed from G Meardi, 'The Trojan Horse for the Americanization of Europe? Polish Industrial Relations Towards the EU' (2002) 1 *European Industrial Relations Journal* 80.

[18] Council Directive 2001/23/EC on the protection of acquired rights of employees in the case of transfer of business (a consolidated text of Directives 77/187 and the amending Directive 98/50); Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies [1998] OJ L225/16 (see its predecessors Directive 75/129/EEC and Council Directive 92/56/EEC of 24 June 1992 amending Directive 75/129/EEC on the approximation of the laws of the Member States relating to collective redundancies [1993] OJ L041/50); and Council Directive 80/987 on protection of outstanding claims of employees in case of insolvency of their employer.

post 1989 economic reforms released untamed freedom, which often triggered a backlash by political parties and governments. Third, the accession process has introduced a gradual process of institutional change. In this process, the new Member States have acquired expertise and sophistication. Increasingly, institutional reform meant not simply the translation of existing EU rules, but the transplantation of labour law systems into the former socialist countries.[19] This is apparent in the adoption of individual directives discussed below.

Transfer of Undertakings

The purpose of Council Directive 77/187[20] was to safeguard the acquired rights of employees in cases of change of ownership as a result of a business transfer. In the socialist era, there were no transfers of the kind envisioned by the directive. Such a transfer entails a legal transaction where each party has the power to transact and transfer assets. Under the socialist system such rights were not available to non-state parties. Instead, the reorganisation of state owned enterprises was managed and controlled by their respective supervisory body, such as a ministry and was typically motivated by political considerations.

Under the prevailing ideology, all productive assets were owned by the people or the state. Transferring from one enterprise to another resembled a transfer of an employee in a market economy from one plant of the corporation to another, without formal change of employer. As a result, the rights workers had accrued during their previous employment with a different state employer were fully transferable. Employment benefits such as salary, annual holidays, various bonuses etc, were connected to the length of employment in the 'socialist sector of economy' and workers could in principle carry their accumulated rights throughout their working life. When workers were moved ('transferred') upon the initiative of the employer to a different agency or enterprise, they were entitled to the same benefits they had previously enjoyed. In other words, while a legal institution called 'transfer' existed in the socialist system, its function was different from the transfer of employees covered by the EU directive. It served the goals of the command economy, ie the free re-allocation of workers between state

[19] Again a typical post-socialist phenomenon, a mixture of inherited disrespect of law and de novo struggle to comply with the new requirements of the rule of law and European harmonisation.

[20] Council Directive 77/187/EEC of 14 February 1977 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses [1977] OJ L061/26, as amended, now in the consolidated text of Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses [2001] OJ L082/16.

owned enterprises. By contrast, the transfer directive addresses situations where competitive pressures result in changes in the ownership structure of firms, which in turn entails a transfer of employees from one employer to another. The socialist transfer norms can therefore not be deemed predecessors of the relevant norms in the AC.

In the post-1989 period, the law ceased to protect credits and entitlements accrued by one employee in the case of transfer of business. While not unusual for market economies, the impact was harsh on workers who not only were forced to seek new employment opportunities, but were suddenly deprived of the fruits of decades of working life. The new Labour Code of 1992 went so far in abolishing the past that it did not contain any norm on workers' rights and entitlements when the company that employed them changed hands. In its desire to erase the legacy of the past and to hail values opposite to those upheld under the old regime, the labour code fostered a pro-investor environment intended to treat legal succession no differently from other cases of simple transfers of ownership for employers. That is, the worker was considered simply as a newcomer at the successor firm with no seniority. In fact, he was frequently hired for a probationary period. The law thereby ensured that no burden was imposed on the prospective buyers of state property.

In the nascent and rudimentary markets of the early 1990s, this legal gap resulted in vast and massive harm for workers of the formerly state owned and now privatised companies. The dissolution, sale or lease of large state owned companies were common occurrences. This created a wave of litigation and a public outcry, which prompted the Hungarian Supreme Court to issue a binding[21] 'Resolution of the Labour Collegium'[22] soon after the Labour Code entered into force. This resolution mandated the continuity of existing labour contracts in the case of succession. This special 'labour law succession' was very similar, although not identical to the business transfer as regulated by the relevant EU directive. It addressed only the imminent and burning problem of preserving the continuity of the employment relationship when workers were 'offered a job' by a new employer as a result of a business action (sale, rent, leasing, etc) with their previous employer. Far from the level of protection provided by the EU Directive, the Court's guideline focused only on those who were transferred to a new employer, but disregarded those who lost their job as a result of the transfer.

[21] The Hungarian Supreme Court has the right to issue guiding decisions that, either formally, or simply because of the power of the Court to review any case, are binding on the lower courts.

[22] 'Resolution no 154 of the Labour Collegium' in E Lukacs, L Maka, J Radnay, J Zanathy (eds), *Principal Labour Resolutions 1970–1944. Labour Law in the Mirror of Court Decisions. Collection of Civil Court Decisions vol I* (Budapest, HVG-ORAC Publishers Ltd, 1995) 187–8.

The Court's decision was openly and consciously *contra legem* — and as such, in contradiction with its constitutional role. The Court's disregard for formal law when it is thought to be inadequate, as well as the reluctance of the Constitutional Court[23] to instruct the legislature on labour law matters within existing constitutional constraints, was characteristic of the amorphous legal situation during the post-socialist era.

The divergence between the law on the books and the Courts' intervention *contra legem* created a situation of uncertainty for parties on both ends of the employment relationship. Employers were confronted with unpredictable legal rules and employees were still without adequate protection. While the effect of a new law would have been limited by the principle against the application of ex post facto laws, the court's interpretation applied to any case that reached the court within the three year statutory limitation for labour law claims. Although this 'interpretative regulation' made it in principle possible to make claims retroactively, the legal uncertainties surrounding it still exposed employees to the superior bargain position and legal expertise of employers.

The legislature made no attempt to correct the blatant divergence between statutory law and the Courts' ruling until 1997, when Hungary was required to speed up the harmonisation process. Reluctantly, a few words were inserted into the Labour Code to harmonise the code with Council Directive 77/187. However, these changes hardly exceeded the protection provided by the court guidelines.[24]

The new Directive (2001)[25] as well as the deadline for accession made it necessary to revise, update, and also upgrade the text. Amending the 1992 Labour Code, Act XX of 2003, effective as of 1 July 2003, introduced most of the necessary corrections and filled the gaps of the first harmonisation experiment.[26] Still, a number of imperfections are present. Some elements of definitions stated in the Directive are missing;[27] the law skips the issue of 'constructive dismissal' and the application of the provisions on transfer in

[23] The role of the judiciary under the Constitution is to apply and not to create law (Art 50 (3): the courts are 'subordinated' only to the law). Nevertheless, the Constitutional Court rejected a petition seeking a declaration that the Supreme Courts' decision (clearly in violation of the provision of law and the Constitution) was unconstitutional. The claim of the petitioners was for a decision obliging the Parliament to adopt a law on legal succession. See Resolution of the Hungarian Constitutional Court no 500/B/1994. AB of February 20, 1995.

[24] See Art 85/A and the governmental explanation of the bill emphasising that the amendment takes place under the harmonisation duty.

[25] Council Directive 2001/23/EC of 12 March 2001 right, see above, n 20.

[26] Changes included the introduction of a definition of 'transfer' (Art 85/A), the mandatory transfer of employment relations, new provisions to assure proper functioning of the right of workers to information and (Arts 56/A and 56/B and 85/B), protection against dismissal that is based merely on the fact of the transfer Art 89 (4).

[27] For a more exact correspondence with the Directive see the new Slovak Labour Code of July 2001, Art 28.

the context of bankruptcy,[28] to give just a few examples. These oversights suggest that the slow, cautious, long stretching accession process that suddenly sped up in the last two years has still not been enough to adequately prepare the new Member States. The harmonisation process will therefore continue in Hungary even after the accession, and the same seems to be happening in the other new Member States from the region.[29]

Group Dismissals

Regulations on collective redundancies by Council Directive 98/59/EC[30] restricted the employer's right to dismiss its employees in order to assure adequate preparation and participation for those affected.

Restrictive regulation on group dismissals did not exist in the socialist command economy, because it was uncalled for. First, full employment was guaranteed. Moreover, employers had incentives to keep employees during slow periods rather than dismiss them, ie to fend against unplanned labour shortages. Second, the employer's right to terminate employment was in any case highly restricted by law and by the powers vested in the trade unions. Even if the union's role was mostly confined to rubber stamping the employer's decision, their involvement created disincentives for dismissals if only by imposing bureaucratic-technical burdens on the employer. In addition to disincentives created by the union, dismissals were monitored by the communist party officer at the company, whose consent was indispensable in cases of multiple dismissals. In the rare event that a company was restructured and employees were dismissed, they were always placed at another state enterprise. While this was done with or without the consent of the workers, workers were never dismissed without some consideration for their future. At face value, these rules seem to resemble the EU norms on collective redundancies, which call for consultations with representatives, the notification of external authorities and the involvement of the authorities in the process of placing the dismissed employees in other companies. Despite the similarities, the 'old' rules were designed for a very different economic system.

[28] Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses[2001] OJ L082/16, Arts 4 (2) and 5.

[29] M Sewerynski, (1997) 'Prospects for the Development of Labor Law and Social Security Law in Central and Eastern Europe in the Twenty First Century' 18 *Comparative Labor Law Journal* 182 at 200, forecasts that the process of harmonisation will 'accelerate' after some candidates receive full fledged membership.

[30] Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies [1998] OJ L225/16. See also its predecessor, Council Directive 75/129/EEC of 17 February 1975 on the approximation of the laws of the Member States relating to collective redundancies [1975] OJ L048/29.

The situation changed dramatically in the wake of privatisation. Since the over-protection of workers as well as over-employment were blamed for the economic inefficiencies, dismissals were made easier in the legal sense, and were also supported by public opinion, at least at the beginning. Efforts to protect redundant labour against dismissal were seen as attempts to preserve the socialist waste-economy, while restricting the freedom of the private employer and discouraging potential investors. Thus when the need to address the growing and massive unemployment rate arose, the regulation of group dismissal was applied as an instrument to cope with unemployment, and not as a restriction on the employer's right to dismiss.

The first steps taken in handling group dismissals, not only in Hungary, but across the CEE region, were in the form of assistance to those who had been dismissed and intervention by labour market agencies.[31] The law on unemployment[32] obliged the employer to inform the competent labour market agency and workers' representatives on the planned group redundancy. This served the purpose of facilitating the reception of redundant labour by the labour markets. Although there was a duty to consult with the workers' representatives, the consultations were merely about technical details concerning the realisation of the employer's decision. Reasons for the scale of the dismissals, and alternative solutions were not a matter for consultation.

The norms were implemented in what may be called a typical '(post)socialist way', permeated with failures and misguided reactions. Three elements can be identified that are more or less characteristic of labour law implementation:

1. Evasion: At first, employers simply ignored these provisions. This pattern was similar to past practices of disregarding legal provisions. Supreme Court decisions that frequently invalidated dismissals were needed to bring the employers into compliance with their duty to give workers a 30-day written notice of a planned dismissal.[33] Moreover, information and consultation rights were not enforced.

[31] The right to adjust state assistance to the labour market position resulted in Poland in large extra benefits being paid to miners that were dismissed in groups. See M Sewerynski, 'Poland' in U Carabelli and B Veneziani (eds), *Labour Flexibility and Free Market — A Comparative legal view from Central Europe* (Milano, Giuffrè Editore, 2002) 225 ff.

[32] Arts 22–23 Act no IV of 1991 on the Promotion of Employment and the Assistance to the Unemployed. *Törvények és rendeletek Hivatalos Gyujteménye [Official Bulletin of Laws and Decrees*] 1992 (Budapest, Közgazdasági és Jogi Kiadó),18.

[33] See: *Bírósági Határozatok Tára [Bulletin of Court Decisions*] (HVG-ORAC Publishers, further on: BH) 1995, no 130, 149, BH 1996 no 66, 67, BH 1996 no 285, 387–8, BH 1996 no 401, 549–50.

2. Employees' self-defence: Since protective norms prohibited dismissing vulnerable (sick, pregnant, long absent) workers, the notified employees could use the information to put themselves under a protective rule and thereby block their dismissal. Taking an extensive sick leave as a'self-defence' when the workplace situation became unstable was a widely known practice.
3. Employers' self-defence: Employers used similar strategies to escape the reach of protective labour law provisions. They dismissed employees in smaller groups, making sure that they stayed just below the lower limit of the definition of a group dismissal. This was called 'slicing' and became a general practice, which also helped avoid consultation and pre-notification obligations.

Legal provisions on group dismissals were inserted into the Labour Code in 1997 as a part of fulfilling Hungary's harmonisation obligations. The new regulation changed the narrow definition of group dismissal (making it broader and more elaborate) and set up the basic rules of the consultation and information procedure.

The introduction of the new group dismissal rules signalled a shift from treating these rules as only an instrument to combat unemployment to that of a mechanism that was designed to foster cooperation between workers and employers in critical situations. Largely though, the purpose of the instrument is to slow and scale down the dismissal process and provide a cushion for those who are ultimately dismissed. Nevertheless, these new collective rights were effectively applied only where there was a strong labour organisation or where the employer (typically a larger multinational with skilled, professional human resource management) attributed importance to the dialogue with the workers' representatives and wished to effectuate a smooth implementation of a reduction in staff.

The amendment of the Labour Code, effective 1 July 2001, adjusted the existing regulation to Council Directive 98/59, replacing Directive 75/129.[34] On this occasion the procedural rules were further elaborated in order to promote efficient implementation. The government also tried to create incentives for employers to comply with the provisions requiring collective consultations, including financial support for the operational costs of joint committees that worked on the placement of the redundant labour, or for training costs.[35]

[34] See above, n 26.

[35] This support helps the idea of developing EU style 'social plans' as a new wave of dismissals — mainly by EU national employers — is foreshadowed by the approaching accession, which is likely to increase labour costs. So far, however, their application has been rare. See S Borbély, 'EFFAT-Hungarian National Integration Commission Seminar, Budapest, 26–27 of April, 2002' (30 April 2002). <http://www.konfoderaciok.hu/mszeib/eng/news/conlusion.htm> (11 September 2003).

Insolvency: Protection of Employees and of their Outstanding Claims

The third among the triad of directives dealing with company restructuring is Council Directive 80/987 which is designed to protect outstanding claims of workers in case of insolvency of the company.[36] The observed patterns are by and large the same as for the previous two examples: No equivalent rule existed under socialism; the immediate post-1989 period gave rise to rather chaotic circumstances; and finally, the struggle to harmonise the law with EU directives brought some settlement in this area of the law.

Under state-socialism, the issue of insolvency was simply not relevant. No private employer can possibly match the guarantee of protection against insolvency as when the state is the employer. Insolvency of state owned enterprises was not foreseen for most of the socialist period.[37] By implication, bankruptcy law was not part of the economic laws adopted during the socialist period. To be sure, state owned enterprises were liquidated from time to time, however, this was done by way of administrative decision of a state agent based primarily on political considerations independent of the economic performance of the state owned company. The first bankruptcy law was enacted in Hungary in 1986.[38] This marked the third phase of experimentation with market type reforms, of which Hungary was a pioneer among the Soviet Block countries.

During the post-1989 process of privatisation and restructuring of the economy, which was characterised by a high turnover of firms, the position of employees vis-à-vis an employer's bankruptcy conformed to the situation recounted already. On the one hand, there were some remnants of state intervention aimed at protecting employee claims.[39] On the other hand, the untamed freedom of the market created pressures that rendered existing legal provisions and institutions insufficient for the effective protection of such claims. Workers usually bore the brunt of fraudulent schemes, common in many of the former socialist countries, under which companies were established, hired employees and raised capital, only to see the company promoters disappear over night under the shield of limited liability. Under such conditions, workers are powerless in enforcing any legally guaranteed rights.

[36] Council Directive 80/987/EEC of 20 October 1980 on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer [1980] OJ L283/23.
[37] Only in the last years did some countries adopt rules governing the bankruptcy of state owned enterprises, as it became increasingly apparent that the state could not guarantee their survival anymore. Hungary adopted its first bankruptcy law in 1986. See below, n 38.
[38] Law Decree no 11 of 1986 *Törvények és rendeletek Hivatalos Gyujteménye [Official Bulletin of Laws and Decrees]* 1986 Volume I (Budapest, 1987. Közgazdasági és Jogi Kiadó), 135–47.
[39] Remnants of state intervention are noted by the treatment of employees as priority claimants in the bankruptcy laws, as well as by undertaking temporary state guarantees for claims against privatised state companies.

A particular feature of Hungarian transitional law and not known in the EU, was the creation of the 'Wage Guarantee Fund', which was established in 1994.[40] Its purpose was to guarantee the continuity of wage payments to employees working at a company in a state of bankruptcy. The law that established this fund was declared 'compatible' with Directive 80/987 after an amendment that was introduced in 2001,[41] despite the different purposes of this law and the EU directive on workers' rights in bankruptcy.

In order to comply with harmonisation commitments, the candidate countries have frequently opted simply for the translation of EU legal norms into domestic law — leaving any elaboration or considerations concerning the viability and implementation of these norms to the future. This can be explained by the enormous time pressure, but also by the fact that the former socialist countries were quite accustomed to adopting 'Patomkin laws' designed to signal compliance, but not to be implemented. Formal Patomkin compliance has been particularly prevalent in the area of insolvency regulations. The domestic law that transforms the directive corresponds closely to the text of the directive. However, Hungary lacks the resources to ensure real protection of employees' claims. Similar patterns can be observed in other transition economies. An example is Slovakia, where the text of the original directive was only slightly amended.[42] A slightly different example is Latvia, which was forced to amend its 1997 law on wage guarantee funds to comply with the EU directive and did so by adopting a revised law closely following the wording of the directive in 2000.[43]

To summarise, the Hungarian experience with transforming relevant EU directives on workers' rights reveals a pattern that also characterises the experiences of other CEE countries. In the planned economy, there existed institutions that were similar at face value, but were designed for a very different economic system. In the immediate post-communist period, the socialist labour protections were replaced with the untamed power of employers. On several occasions, the excesses that resulted were corrected by hastily adopted emergency legislation, which was frequently legally

[40] Act LXVI of 1994 on the Wage Guarantee Fund. *Törvények és rendeletek Hivatalos Gyujteménye [Official Bulletin of Laws and Decrees]* 1994 (Budapest, 1995, Közlony- és Lapkiadó Kft., Bulletin and Periodical Publishers Ltd), 601–5.

[41] *Ibid* Art 15 (2). This may be deemed quite an unusual way of 'harmonisation' and confirms the impression that the outstanding claims of the employees are not adequately guaranteed by the Hungarian legislation. In other words 'check the box on the checklist' style of harmonisation does not guarantee implementation, especially where financial resources are lacking. However, these implications are largely overlooked by the EU.

[42] A good example for this is the Slovak Labour Code of July 2001, Arts 21–5.

[43] See the 2000 Law on Establishment of Guarantee Fund for Fulfilment of Employees' Requirements Relating to Labour Relations in Bankrupted Enterprises or Enterprises under Bankruptcy. Law on the Protection of the Employees in Cases of the Insolvency of the Employer; adopted on 28 December 2001, published in Latvijas Republikas Saeimas un Ministru Kabineta Ziòotâjs (The Reporter of the Saeima and the Cabinet of Ministers of the Republic of Latvia) # 2 2002.

questionable and imperfect. The accession process has forced the transition economies to bring their laws in line with existing EU standards. The transposition of labour protection law has frequently been slow, if not reluctant, and has disregarded the need to ensure enforcement and implementation. Thus, while the harmonisation process was complete in mid 2003, ie 'seconds' before the accession treaties were signed, the actual alignment process will require more time, including intensive court activity both at the national and at the European level.

Changing Existing Institutions

Undisputed Improvements

A considerable part of the AC in labour law relates to subject matters that had long been regulated in the candidate countries. When compared with the more sophisticated regulations of the EU, however, previously existing regulations and their implementation must be regarded as inadequate.

With regard to safety at the workplace, the protection of young workers, and the prohibition of discrimination, the communist era may be said to have pronounced the relevant principles, but failed in implementing them. Thus, a considerable gap developed between the law on the books and the law in practice, which was openly tolerated. By comparison, the EU's commitment to these principles dates back to the original Treaty of Rome. Finally, these rights are associated with fundamental civil rights in the EU and its Member States.

Obviously, there are differences between health and safety regulations on the one hand, and discrimination on the other. Health and safety regulations in the socialist period were enforced if violations went beyond some moderate level that was accepted even by workers. Large state owned companies were monitored by labour inspectors, and serious violations of safety standards could cause discomfort for the trade unions and create political repercussions. Additionally, the violation of safety regulations could cause financial obligations in the form of reimbursements to social security funds for compensation paid to injured workers. Furthermore, workers who had suffered damages could bring civil suits.[44] Finally, the prohibition on child labour was observed by the major state employers. Still, child labour

[44] Claims regarding occupational disease and injury belonged to the exceptional group of labour disputes that had full access to the courts. Such claims together with certain (more serious) cases of employees' liability for damages were the only labour law cases to be taken to court on the basis of the Labour Code of 1967. From 1973, when access to one-instance court procedure became general for most labour cases, the opportunity to appeal against the first instance decision was possible only in this group of cases whereas the rest of cases (eg cases of unlawful dismissal, wage claims, appeal against disciplinary punishments etc) became final and binding with the first instance court decision. Under the conditions of labour shortage and

flourished and was ignored by the relevant authorities, if conducted outside the sectors that were most closely monitored by the state.

Privatisation resulted in massive violations of existing health and safety provisions. In part, this can be attributed to the ignorance of many small and medium size entrepreneurs of the very existence of these rules. In part, the abuses reflected the altered power relations between employers and workers during the transition period.

Discrimination was a different matter. Despite its formal commitment to equality, gender as well as ethnic discrimination was rampant at the workplace, and yet it was ignored. Cases that were publicised were declared to be exceptions and little happened to correct the situation or to help victims of frequent discrimination to seek remedies. Litigation on the grounds of discrimination was unknown in the CEE socialist countries, including Hungary.

After the political and economic shift in these countries, the right to equal treatment came under two different influences. First, as a reaction to the formerly extensive labour market participation of women, which was forced upon them by economic and political pressures, the role of motherhood was now elevated. Governments in CEE countries occasionally launched campaigns that characterised the working mother as a communist device designed to exploit and destroy the family. Second, the greater awareness of human rights and political freedom, and the mushrooming of civil society organisations helped in raising the consciousness of the problem and in providing assistance to victims of discrimination.

In this respect, enlargement is important not so much as a device to change the formal rules of the game but as a way of educating the people. Article 5 of the Hungarian Labour Code created a broad provision for liability and reversed the burden of proof in 1992, five years before existing European legislation. Nevertheless, the formal enactment of this provision has not been met by actual enforcement. Some aspects of the EU directives have not been transformed or they have been transformed in a manner that is likely to impede the realisation of equal treatment.[45] The former is true, for example, for the provisions on spreading information and on retaliatory dismissals. Nevertheless, there are grounds to believe that the importance of gender equality reflected in EU standards is having an impact on changing distorted values. An important sign of this direction is the recently created Minister (without portfolio) for Equality of Opportunity. Moreover, training programs with EU assistance for legal professionals, judges as well as civil activists, have brought tangible change in the area of gender equality.

guaranteed employment, workers were less reluctant to sue their employer for damages than they are today.

[45] Such is the provision in the Labour Code, regarding the relevant provisions for remedying unlawful discrimination, adding that 'the remedy for discrimination must not affect unfavourably the rights and duties of others.' The role of the courts will be very important, provided that the claimants will find the way to the court.

Mixed Results

Although socialist labour legislation provided better terms and conditions of employment in comparison to the EU and its Member States, the fear that accession would result in a deterioration of labour standards proved unfounded.

EU harmonisation was sometimes used as a guise by the post-socialist governments of the candidate countries,[46] including Hungary, to introduce measures that decreased the level of existing protections. A closer look, however, typically revealed that these measures were not required by harmonisation, and in some cases had no basis in EU legal norms. In fact, the legal changes may have been implemented in order to enhance the competitiveness of former socialist countries' national economies. To make them palatable domestically, however, they were wrapped into or hidden under the veil of EU harmonisation.

The most remarkable case in Hungary was the transposition of Council Directive 93/104/EC[47] on organising working time in 2001. The draft proposed by the government removed a number of restrictions on the freedom of employers to set working time[48] and justified this by referring to harmonisation requirements. While the proposed changes were consistent with the directive, they violated the non-regression clause in this (and other directives), which states that '[the] Directive shall not constitute valid grounds for reducing the general level of protection afforded to workers.'[49] The matter resulted in heated debates between the government of the day and the trade unions and may have contributed to the fall of the coalition at the 2002 parliamentary elections.

Other examples have been less conspicuous, yet exemplify a similar strategy. The transposition of Council Directive 91/533[50] on the employer's obligation to inform employees of the conditions applicable to the contract or employment relationship was used by the government to try to limit the

[46] For an example on Estonia, see M Tuch, 'Estonian labour law reform — flexibility or race to the bottom?' (2002) 3 *South East European Review* 82.
[47] Council Directive 93/104/EC of 23 November 1993 concerning certain aspects of the organization of working time [1993] OJ L307/18 (Working Time Directive).
[48] Among others, the clear distinction between regular and overtime has been removed in reference to the absence of such a distinction in the Working Time Directive. Employers may therefore, within certain limits, use overtime work without paying extra to the employees. Weekly working hours have been decreased from 42 to 40 hours with reference to the European 35-hour minimum. Extra payment (this has been 'restored' in the meantime), and the scope of exceptional employees, which fall under less favourable norms was broadened considerably. See Act no XVI of 2001 *Törvények és rendeletek Hivatalos Gyujteménye [Official Bulletin of Laws and Decrees]* 2001 (Budapest, 2002, Magyar Hivatalos Közlönykiadó) 106–29, Art 15, at 113–16 and the pertinent ministerial explanation.
[49] Art 18 (3) of Council Directive 93/104/EC of 23 November 1993 concerning certain aspects of the organization of working time [1993] OJ L307/18.
[50] Council Directive 91/533/EEC of 14 October 1991 on an employer's obligation to inform employees of the conditions applicable to the contract or employment relationship [1991] OJ L288/32.

scope of contracted terms in favour of conditions that are unilaterally set by the employer and create merely an obligation to inform the employee.[51] Similarly, the transposition of the posted workers directive[52] created an opportunity to increase the maximum time by a factor of three that a worker could be assigned per annum to a different workplace.[53]

This strategy did not come without costs, as signalled by the decreasing support for EU accession, which at least in part resulted from the perception created by the government that anti-employee laws formed part of the EU accession requirements. Even though all CEE accession countries have meanwhile supported accession in nationwide referenda, the risk of alienating the population from the European cause is still present.

CHANGES IN INDUSTRIAL RELATIONS: EMPLOYEE INVOLVEMENT

The AC does not include laws on trade unions. The freedom of association and collective bargaining is the prerogative of the Member States.[54] Nevertheless, employees have extended information and consultation rights at the EU level and trade unions play a significant role in the representation of workers in such matters, notwithstanding the fact that community law remains intentionally silent on this form of representation. As such, trade unions also play an important role in the social dialogue at the European level.

The same model could also, in principle, be put into practice in accession countries. However trade unions in these countries seem to have difficulties accepting the role of background players, which in turn may negatively impact on the transposition of sections of the AC that implicitly rely on union representation. The deeper reasons for the lack of adequate union participation can be found in the socialist past of these organisations. However, change may come from credible and legitimate EU examples.

[51] Such as the place of work. See also Art 76/C (4).
[52] Council Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services [1997] OJ L018/01.
[53] A clarification of the various forms of work carried out away from the contractual workplace in correspondence with Art 1 (3) (a)-(c) was, indeed, necessary. Thus, the only term for such work ('[temporary] transfer') found previously in the law was divided into transfer, posting and temporary assignment. This change was an excuse for the government to nearly triple the time a worker might be required to work outside his contractual workplace. See Arts 85, 105 and 106, above, n 9.
[54] Amsterdam Treaty, Art 137 (6).

Repercussions of the Past: Resistance Against Two-Tier Representation

Trade unions occupied an eminent political role in the maintenance of the authoritarian regime. In spite of their name, however, they did not function as genuine trade unions. In fact, trade unions were deprived of their freedoms, had forced membership, were subordinate to the communist party and thus transformed into a pillar of communist power. As diverging interests were excluded from the ideology of the totalitarian party-state, the function assigned to trade unions was to represent workers as 'owners of state property' and as 'training schools of communist self-management', which functioned as a substitute for democratic political participation. In order to fulfil their tasks, trade unions were granted a number of privileges, such as seats in controlling and managing bodies at all levels of the political hierarchy, including the government and supreme party organs, and participated in the decision making process of state owned enterprises. Although their powers were mostly formal — perhaps the only true role they could play was in providing social welfare benefits — trade unions in general and workers' participation in particular became associated and identified with the totalitarian regime.

The repercussions of the past have cast shadows on the present state of the unions and the very idea of workers' participation. The previous lack of freedom of association turned into an excessive freedom to organise[55] which produced a large number of small rival unions that were frequently divided along political lines.[56] Mandatory union membership of the past regime resulted in sudden loss of membership when negative freedom, ie the right to disassociate, became guaranteed. The industrial restructuring process has strongly contributed to the erosion of membership. New private employers also tried quite successfully to keep trade unions out.[57] If co-ownership of

[55] A minimum of five founding members are enough in the CEE candidate countries to establish a trade union. In Hungary, a minimum of 10 are needed (see Act II of 1989 on the Right to Association, Art 3, para 4). Latvian law, however, did not prescribe a lower limit. See Law on Public Association of December 15 of 1992, Art 4. Law On Voluntary Organizations and their Associations, adopted 15.12. 1992, with subsequent amendments; published in *Latvijas Republikas Augstakas Padomes un Valdibas Zinotajs, [the Reporter of the Supreme Council and Government of the Republic of Latvia]* 1993, no 1/2.

[56] For more on the division between 'old' and 'new' unions, see C Kollonay Lehoczky, 'Trade Unions Facing the Challenge of Privatization in Europe. New Strategies' *Economic and Political Changes in Europe. Implications on Industrial Relations* (3rd European Regional Congress of IIRA), (Bari, Cacucci Editore, 1993) 309–40.

[57] The former (forced) membership rate of approximately 90 % had fallen to between 15 and 40 %. Slovenia has the highest membership rate at 41.3%. Hungary is in the lower 20 percentile. See M Lado, 'Industrial Relations in the Candidate Countries' (2002) *The European Foundation for the Improvement of Living and Working Conditions* ('Eurofund') \lt;http://www.eiro.eurofound.ie/2002/07/feature/TN0207102F.html\gt; (21 October 2003), on the situation of trade unions after privatisation; see A Trif, 'The transformation of industrial relations in Romania at the micro level' (2000) 4 *South East European Review* 139–60, based on a survey of 15 companies in Romania and one in Hungary.

the people's property was the basis for workers' participation in the past then it was only logical that a market economy would eliminate the need for workers' participation at a political level. Having their classic freedoms guaranteed by the Constitution, trade unions were liberated from dominance by the communist party power. But, at the same time, they were 'freed' of the privileges they had enjoyed under the socialist regime, which were incompatible with the market economy or trade union pluralism. In the end, freedom alone, absent experience in the radically changed environment or the support of mass-membership, was not sufficient to enable trade unions to be an effective protector of workers' rights.

It is therefore not surprising that post-socialist trade unions have displayed a considerable amount of suspicion when confronted with non-union forms of workers participation.[58] This attitude, which may be said to resemble the traditional attitude of American trade unions towards works councils and any form of non-union representation, can be explained in CEE in part with the past experience with 'workers' participation', which was manipulated by governmental and managerial powers[59] The fear of loosing still existent rights in order to have a word in managerial decisions may have played a part as well.[60]

Hungarian Works Councils and Trade Unions

The situation in Hungary was slightly different from other post-socialist economies as a consequence of the early introduction of market-type reforms, which dates back to the late 1960s. The limited and cautious acknowledgement of separate interests of employees and trade unions created the need for a second channel of representation for employee participation in managerial decision-making. From the mid 1970s, several legislative steps were taken to introduce some form of 'direct representation' of the labour force. From the mid-1980s onwards, even ownership rights were allocated to workplace bodies. It was hoped that these various forms of labour participation would help in making the economy more efficient by

[58] See M Weiss, 'Industrial Relations and EU-Enlargement' in R Blanpain and M Weiss (eds), *Changing Industrial Relations and Modernisation of Labour Law. Liber Amicorum in Honour of Professor Marco Biagi* (The Hague, Kluwer, 2003).

[59] G Gradev and M Stajonevic, '"Workers" representation at company level in CEE countries' 1 *Transfer* 31.

[60] Eg such a right to empower trade unions to counterbalance managerial power is the Hungarian right of the trade unions to 'raise a veto' against managerial decisions (Art 23 of the Labour Code). Several similar rights in the labour codes of other CEE countries can be found. See for example the Slovak Labour Code of July 2, 2001. While empowering the trade unions with important consultation and information rights in connection with measures concerning individual employment rights, Art 17 (2) invalidates 'a legal action that was not discussed with the competent trade union body beforehand.'

detaching state enterprises from bureaucratic state control and by mobilising the initiative and energy of workers.

The 1989 modification of the socialist Labour Code of 1967 entirely abolished all previous information, consultation and co-determination rights of workers' representatives in all forms of business organisations and maintained such rights only for employees of the shrinking state owned enterprises.[61] The main motivation of this move was to shield the new private — and particularly foreign (frequently EU nationals) — investors from the 'tiring' dealings with employee representatives. A similar trend can be observed in Poland. Works councils, which had been hailed for the heroic role in counter-balancing communist trade unions during the period of martial law when *Solidarnosc* was panned, replaced the board of directors and supervisory boards in privatised companies.[62]

In Hungary, the Constitutional Court regarded trade unions as a potential danger for civil liberties and dignity, and was active in invalidating old and new laws on trade union rights and privileges in order to relegate trade unions to 'one of the many' civil organisations without any special status.[63]

Against this backdrop, Hungary established workers' councils in the 1992 Labour Code. The main purpose was to institutionally separate workers' participation in the managerial decision making process from trade union rights and freedoms. Although the Hungarian trade unions shared the CEE trade unions' concerns about work councils, they acquiesced in part because of the strong influence they were given over the election (and consequently the operation) of the work councils.[64] On the other hand, employers and governments were 'reassured' by the relatively weak position of the works councils, which was far from the powers granted to the *Betriebsrat* in Germany, which served as a model. Article 65 of the 1992 Labour Code allowed co-determination in matters relating to the use of funds allocated to social welfare purposes (in lack of such funds no co-determination right exists), thereby practically restricting works councils' rights to providing

[61] See Act V of 1989 amending Act II of1967, the 'old Labour Code' discussed further below. The same logic worked in Poland confining 'workers' councils' to the shrinking state enterprises.

[62] The Law of July 13 1990, Dziennik Ustav No 51, item 298 on privatisation of state enterprises. See A Swiatkovsky, 'Labour Law Reform in Poland' in S Frankowski and PB Stephan III (eds), *Legal Reform in Post-Communist Europe* (Dordrecht, Martinus Nijhoff, 1995) 330–1.

[63] For a detailed description of the early 1990s Constitutional Court decisions regarding trade unions see C Kollonay Lehoczky and M Ladó, 'Hungary' in U Carabelli and B Veneziani (eds), *New patterns of collective labour law in Central Europe* (Milano, Giuffré Editore, 1999) 114–19.

[64] Eg it is possible — and this is in fact a frequent occurrence — that the president of the works council and the president of the local trade union organisation are the same person.

information and 'giving opinions'. Face-to-face consultations were not provided for.[65]

The peaceful cohabitation of trade unions and works councils has undergone some fluctuations paralleling changes between right and left wing governments. Overall, however, they worked well until 1999, when an amendment to the Labour Code provided for the conclusion of a 'works agreement' between the works council and the employer, determining the terms and conditions of individual employment contracts, which previously had been part of the collective agreement. Such an agreement was effective only as long as there was no collective agreement covering the workplace. Nevertheless, trade unions considered this legislative step as a further proof of the government's anti-union agenda towards debilitating trade unions, and looked at works councils as non-independent competitors in the collective bargaining process.

The short-lived amendment was immediately abolished upon the shift in government following the 2002 elections.[66] The allocation of the right to represent workers' interests remained a political issue boosted by the trade unions. Recent modifications to the law have 'restored' trade union rights that had previously been abolished.[67]

The controversies also impacted on the harmonisation process. The rules adjusting Hungarian legislation on company transfers to the EU law, for example, allocated the right to consultation to trade unions. As such they are slightly inconsistent with other rules on employee consultation and information rights that confer such rights to works councils or directly to employees. They also conflict with principles of the Labour Code, namely, that trade unions have their traditional rights, and rights to promote collective bargaining, whereas the Labour Code allocates the role of involving workers in the decision making process to the works council.

In conjunction with more recent modifications of the law that assigns new participatory rights to the trade unions — which closely resemble the 1967 Labour Code — the trends reinforce fears that had been voiced

[65] Art 65 paras (2) and (3), above n 9.

[66] See Act XIX of 2002, Art 14 para (4) *Törvények és rendeletek Hivatalos Gyujteménye [Official Bulletin of Laws and Decrees]* 2002 (Budapest, 2003, Magyar Hivatalos Közlönykiadó) 200.

[67] Most importantly, Art 21 of the Labour Code as amended from September 1, 2002 converted the previous right of unions to information into a right to consultation before decisions are taken that affect a larger group of workers, such as a company's transformation, transfer, reorganisation, restructuring, modernisation, merger or separation. Among others, the new law made automatic deduction of trade union fees from salaries (a vital issue for trade unions) a duty of the employer, whereas previously this had been left to an agreement between the trade unions and employers. Also worth mentioning is the working time benefit of trade union officials, which can now be traded off for money — whereas the previous government had limited such possibilities.

during the early transition period, namely that unions, especially the 'old' ones, are hindering rather than promoting the transition to a market economy.

Tripartism

Their limited role at workplace notwithstanding, post-socialist unions were successful at national level tripartite negotiations. This seems surprising, given that the same backlash and distrust that unions confronted at the work place would have been justified at this level. In fact, manipulation and prostitution of institutional representation had been most vigorous at the political level during the socialist regime. Nevertheless, in light of the numerous pressures the relevant three parties faced (trade unions seeking a new role, employers' organisations emerging from nothing, and governments facing economy crises that demanded the adoption of critical measures) they had a common interest in navigating their country through the most difficult phase of the transformation.[68] Thus, 'transformative corporatism'[69] can be a vehicle for the indispensable renewing of social dialogue in the enlarged European Union, at least as long as corporatist elements are prevented from overgrowing their place.

Summary

In the field of collective labour law, the effect of the past on the transformation process has been stronger and reforms have been more controversial than in the field of individual employment relations. The charade of industrial relations of the past, which in fact had been orchestrated by the communist party, received the requisites of a modern industrial relations' system. Yet, the two systems served different functions. The former socialist countries were challenged to bring about qualitative change while using remnants of past institutions that had every incentive to revert to behaviour learnt in the previous regime.[70] The European accession process, in particular through the support provided by the West European labour movement

[68] See Hethy, 'Tripartism in Eastern Europe' in A Ferner and R Hyman (eds), *New Frontiers in European Industrial Relations* (Oxford, Blackwell, 1994) 312–36.
[69] The expressive term has been invented by E A Iankova, 'Social Partnership After the Cold War: The Transformative Corporatism of Eastern Europe' in J Brady (ed), *Central and Eastern Europe — Industrial Relations and the Market Economy* -Volume 8 of the Official Proceedings of the Fifth IIRA European Regional Industrial Relations (Dublin, Oak Tree Press, 1997) 46, 51 ff.
[70] On the concept of path dependency see above, n 12 and accompanying text.

in the form of training, contacts and the sharing of experience with trade unions and works councils has greatly contributed to enhancing the process of qualitative change.

CONCLUDING REMARKS

The following four brief sections will summarise the major characteristics of the processes described above. They are pertinent not only to Hungary, but also to other transition economies.

Contrasts and Fluctuation

The transition process has brought CEE countries a mixture of extreme liberalisation and old-style institutions. The position of workers as well as the state of labour law fluctuated between old, socialist type, over-protection and elements of untamed 'liberalism' and exploitation. The tendency to re-contractualise labour relations has been present in doctrine, in legislation, in everyday practice of employers, and in the case law of the courts. The developments in Hungary have been characteristic for the whole region, with minor variations.

The fluctuation between the extremes has been strongly moderated by the mandated adjustment to EU regulation on labour. EU accession was of highest priority beyond all political disputes in each candidate country, regardless of the political or economic preferences or philosophies of the party in power. Thus, harmonisation obligations were implemented, sometimes reluctantly, at other times enthusiastically, sometimes by simply copying the relevant text of EU norms, at others by creatively transposing the directives into domestic law. The harmonisation process has not only had a settling and balancing effect on labour relations, it also initiated an intensive and progressive legal development, notwithstanding differences in the speed and quality of adjustment.

The similarity on the surface with old pre-transition, socialist institutions raises the double danger of path dependence and negative repercussions, that is, the danger of sliding back to state-corporatist traditions or suspicious rejection of progressive proposals due to their formal similarity with communist institutions. Nevertheless, this double catch has advantages for the existing Member States as well as for the candidate countries. The contrast between the reoccurring déjà vu feeling and the realisation of substantive differences after closer acquaintance with the new norms and institutions has important educational effects for academics and policy makers as well as for those immediately affected by the rules. Moreover, this contrast may alert experts from existing Member States

and force them to spot potential sources of misunderstanding or to decode dangerous symptoms in the seemingly harmless process of legal harmonisation.

Citizen v Subordinate

Another common feature has been that the developments at the workplace were in sharp contrast to the political developments, with potentially adverse effects for the peaceful transition of the former socialist countries to a democratic society. An intimidated subordinate at the workplace can hardly be a mature and autonomous free man — a citizen — outside the workplace, hindering the formation of a society of *citizens,* without whom the best Constitution cannot create democracy and the rule of law.

Whether a new balance between the protection of employees and the freedom of the market can be effectively established in the former socialist countries has become one of the most pressing economic and political issues in these countries in light of the continuing and potentially explosive hardships employees face. As such, this issue is also highly relevant for the European integration process.

Delayed, Incomplete Process

The much-criticised delay of the accession certainly guarantees a safer unification, for both the acceding and the accepting countries. The slow process will save the material and moral costs that a more rapid enlargement would most likely have entailed, similar to the German unification, which heavily taxed the people of both parts of the country. Irrespective of the reasons for them, the delays in the accession process allowed the candidate countries to make qualitative progress in their domestic, social and economic relations, especially with regard to labour and employment relationships, where the progress was slowed by the above mentioned controversies. The mandate and opportunity to adjust to the AC gradually allowed the new Member States to gain experiences, which will make the merger of the two parts of Europe more organic, leaving room for cultural adjustment. By contrast, unification at a less mature stage would have invariably been more akin to colonisation.

At the same time, it is important to be aware that neither the accession process nor the transition process is yet completed in the field of labour law, irrespective of the formal stamps of approval given to the acceding states as they move from one step to the next in the accession process. While it is obvious that the adjustment process will never end, even for the old EU Member States, there is still an open question as to whether

the approvals were occasionally given hastily, overlooking fake or non-implemented legislative solutions and thereby reinforcing the inherited bad post-socialist attitudes towards the rule of law. The green light for accession — in spite of the delays — might be considered too early, thus questioning the EU's insistence on the social *acquis* and on the realisation of its own commitment to what is called 'the European Social Model'.

The Attitude of the EU

Just as EU law has become the guiding standard for accession countries, globalisation trends exert pressures on Western Europe to reform, to which Europe has responded by shifting back and forth between weakening and strengthening its traditional protective system. The mixed messages sent to the accession countries — primarily through the occasional gap between the declarations on the firm social values of the EU on the one hand, and the lack of consistency in requiring and examining those values on the other — have contributed to the vacillation and slow down of reforms in these areas.

To conclude, the most important question about the immediate prospects of enlargement has a clear answer: Accession will bring sound convergence, and create synergies from the merging two parts of Europe ***if*** the declarations become requirements that are translated into indicators and benchmarks. They must be taken seriously by both sides of the merging Europe and governments should display the same rigor in this field as they do with respect to monetary issues. Whether this will happen depends for the most part on policy choices by current Member States, EU officials and decision-making bodies. So far, the achievements do not quite meet the goals stated at the outset. The future of EU labour law will require that Member States take seriously their commitment to fundamental values declared so many times in various documents, including but not limited to, in the Charter of Fundamental Rights.

References

Casale, G (1999) *Social Dialogue in Central and Eastern Europe* (Budapest, ILO-CEET).

Gradev, G and Stajonevic, M (2003) '"Workers" representation at company level in CEE countries' 1 *Transfer* 31.

Hethy, L (1998) 'From Centrally Planned to Free Market Economies: Industrial Relations Implications' in R Blanpain and C Engels (eds), *Comparative Labour Law and Industrial Relations in Industrialized Market Economies* (Deventer, Kluwer).

—— (1994) 'Tripartism in Eastern Europe' in A Ferner and R Hyman (eds), *New Frontiers in European Industrial Relations* (Oxford, Blackwell).

—— (1994) 'Political Changes and the Transformation of Industrial Relations in Hungary' in JR Niland, RD Lansbury, and C Verevis (eds), *The Future of Industrial Relations. Global Change and Challange* (Thousand Oaks, Sage).

Iankova, EA (1997) 'Social Partnership After the Cold War: The Transformative Corporatism of Eastern Europe' in J Brady (ed), *Central and Eastern Europe — Industrial Relations and the Market Economy* (Volume 8 of the Official Proceedings of the Fifth IIRA European Regional Industrial Relations) (Dublin, Oak Tree Press).

Kornai, J (1980) *Economics of Shortage* (Amsterdam, North Holland).

Lado, M (2002) 'Industrial Relations in the Candidate Countries' *European Foundation for the Improvement of Living and Working Conditions* ('Eurofund') (21 October 2003).

Lehoczky-Kollonay, C (1997) 'The Emergence of New Forms of Workers' Participation in Central and East European Countries' in R Markey and J Monat (eds), *Innovation and Employee Participation Through Works Councils* (Aldershot, Avebury).

Lehoczky-Kollonay, C and Lado, M (2002) 'Hungary' in U Carabelli and B Veneziani (eds), *Labour Flexibility and Free Market — A Comparative Legal View from Central Europe* (Milano, Giuffrè Editore).

Meardi, G (2002) 'The Trojan Horse for the Americanization of Europe? Polish Industrial Relations Towards the EU' 1 *European Industrial Relations Journal* 77.

North, D (1990) *Institutions, Institutional Change, and Economic Performance* (Cambridge, Cambridge University Press).

Pollert, A (1999) *Transformation at Work in the New Market Economies of Central Eastern Europe* (London, Sage).

Radnay, J (1998) 'A munkajog és a polgári jog kapcsolata' [The relationship between labour law and civil law] in Bánrévi, G, Jobbágyi, G and Varga, C (eds), *Justum, aequum, slautare* (Budapest, Osiris Publishers).

Ribarova, K (2002) 'Bulgarian transition and employment relations' 4 *South East European Review* 27.

Sewerynski, M (2002) 'Poland' in U Carabelli and B Veneziani (eds), *Labour Flexibility and Free Market — A Comparative Legal View from Central Europe* (Milano, Giuffrè Editore).

—— (1997) 'Prospects for the Development of Labor Law and Social Security Law in Central and Eastern Europe in the Twenty-First Century' 18 *Comparative Labor Law Journal* 182.

—— (1995) 'Evolution of Polish Labour Law and Collective Labour Relations During the Period of Post-Communist Transformation' in M Sewerynski (ed), *Polish Labour Law and Collective Labour Relations in the Period of Transformation* (Warsaw, Ministry of Labour and Social Policy).

Stark, D (1992) 'Path Dependence and Privatisation Strategies in East Central Europe' *East European Politics and Societies* (Berkeley, University of California).

Swiatkovsky, A (1995) 'Labour Law Reform in Poland' in S Frankowski and PB Stephan III (eds), *Legal Reform in Post-Communist Europe* (Dordrecht, Martinus Nijhoff).

Tomes, I (2002) 'Czech Republic' in U Carabelli and B Veneziani (eds), *Labour Flexibility and Free Market — A Comparative Legal View from Central Europe*. (Milano, Giuffrè Editore).

Trif, A (2000) 'The transformation of industrial relations in Romania at the micro level' 4 *South-East European Review (SEER)* 139.

Tuch, M (2002) 'Estonian labour law reform — flexibility or race to the bottom?' 3 S*outh East European Review (SEER)* 82.

Vimercati, A (2002) 'The Complexity of the Labour Processes in Progress: A Comparative Analysis' in U Carabelli and B Veneziani (eds), *Labour Flexibility and Free Market — A Comparative Legal View from Central Europe*. (Milano, Giuffrè Editore).

Weiss, M (2003) 'Industrial Relations and EU-Enlargement' in R Blanpain and M Weiss (eds), *Changing Industrial Relations and Modernisation of Labour Law. Liber Amicorum in Honour of Professor Marco Biagi* (The Hague, Kluwer Law International).

—— (1995) 'Resolution no 154 of the Labour Collegium' in E Lukacs, L Maka, J Radnay, J Zanathy (eds), *Principal Labour Resolutions 1970–1944. Labour Law in the Mirror of Court Decisions. Collection of Civil Court Decisions* vol I (Budapest, HVG-ORAC Publishers Ltd).

9

The Institutional Conditions for Effective Labour Law in the New Member States

A COMMENT BY MANFRED WEISS

THIS COMMENT ANALYSES the contributions on labour and social law in this volume, especially those by Catherine Barnard and Csilla Kollonay Lehoczky to reflect on the institutional conditions that must be in place for the European model of labour and social law to function both in the new and the old Member States.

Three preliminary remarks seem to be necessary to put Catherine Barnard's chapter in context. First it might be misleading to categorise hard law rules as the old approach of the European Community's legislative policy. It is rather a mixture nowadays with soft law playing an increasingly important role and procedural rules frequently substituting for substantive regulation. Nevertheless, the so-called hard law is as necessary as before. It is also still an essential part of the European Community's social policy agenda. The most recent directive on discrimination[1] is a very good example of the prevailing hard law approach.

Secondly, the Luxemburg and Lisbon strategy on employment policy should not be overestimated. So far, it has not functioned very well. Governments of the Member States, as well as EU institutions, continue to be the most important initiators and actors with respect to EU policy initiatives. As of now, the social partners, ie national employee and employer organisations, have not been fully integrated into this new scheme. Moreover, the real impact of the soft law approach has been marginal and much will need to be improved.

[1] Directive 2002/73/EC of the European Parliament and of the Council of 23 September 2002 amending Council Directive 76/207/EEC on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions [2002] OJ L269/15.

Thirdly, it should be mentioned that the Working Time Directive[2] is a very special case. More than any other piece of law passed by the EU, it is suffering from a lack of legitimacy. The provision of the Treaty on which it is based was not made for the purpose of such a directive. Therefore, the UK has challenged the legality of the directive. The European Court of Justice rejected this challenge in a not very convincing ruling.[3] Thus, while the directive may survive, it is not really accepted as legitimate, particularly in the UK.

At first glance, Catherine Barnard's impressive chapter seems to be only recounting the story of the failure of the Working Time Directive in the UK. A closer look, however, reveals the link to our theme: EU enlargement. Barnard demonstrates what may happen with Community legislation, which relies on the cooperation of collective actors in the Member States, when the relevant actors and collective bargaining arrangements are weak or non-existent. This raises the question of whether a structure is available in the candidate countries of Central and Eastern Europe (CEE), capable of coping with legislation, which is based on the assumption that collective actors can be counted on to prevent the abuse of the possibilities offered by it. There is no easy answer. However, there are dangers which should not be ignored.

The fact that the CEE countries are facing problems is not surprising. After the fall of the iron curtain they were confronted with the dilemma of trying to simultaneously construct political freedom and democracy, a market economy and a balanced social system. They were very successful with regard to the first two goals, but the other two are still lagging behind. Csilla Kollonay Lehoczky's paper very convincingly illustrates this situation. I simply would like to add a few observations.

The CEE countries still lack a functioning structure of industrial relations. The relevant social actors are everything else but strong. Trade union plurality continues to spur fights among different political and ideological factions, thereby weakening the solidarity within the labor movement as such. Trade unions are not only very weak but only represented in specific areas, mainly in the public sector and in the remaining large, partially state-owned companies. In the small and medium-size companies — the pillar of the private sector — they are more or less non-existent. The employers' associations are even weaker than the trade unions. They were unknown in the former communist system and had to be built from scratch. The success so far has been modest. Most employers in the private sector do not yet see the need for becoming members of such organisations.

[2] Council Directive 93/104/EC of 23 November 1993 concerning certain aspects of the organization of working time [1993] OJ L307/18 (Working Time Directive).
[3] Case C-84/94 *UK v Council of the European Communities* [1996] ECR I-5755.

Evidently, the weakness of the collective actors has implications for the efficacy of collective arrangements and collective bargaining systems. In each country there is a tripartite social dialogue at the national level, comprising the respective government and the social partners. There is little doubt that tripartite social dialogue has its merits and has played an important role in restructuring social policy in the CEE countries. However, due to the indicated weakness of the social partners, these arrangements are asymmetric. Their main effect is to legitimise government politics. And they have two side effects which should not be ignored. First, by pre-deciding important issues of social policy they tend to weaken the position of the elected parliaments, thereby potentially undermining the building of democracy. Secondly and more importantly, in the context of labour law they tend to prevent the evolution of autonomous bilateral collective bargaining structures. Nevertheless, one should admit that at present there is no viable alternative to the existing tripartite social dialogue: it is absolutely necessary for creating acceptance for the work on transformation, which has to be implemented.

In view of the weakness of the employers' associations and the non-existence of collective actors in major parts of the CEE economies, it is no surprise that collective bargaining is the exception rather than the rule and that in principle it takes place only at the company or plant level. There is almost no collective bargaining at higher levels: be it the sectoral or the national one.

As far as employees' involvement in management's decision making is concerned, the situation is slightly different. Because of the legacy of public ownership prior to the fall of the iron curtain, there is still much reluctance to accept workers' participation as a feasible governance structure in the new market economy. Nevertheless, there is quite a lot of legislation providing for institutionalised workers' participation. However, three problems remain. First, worker participation plays a role only in big companies. Secondly, in some cases the institutional arrangements follow too closely the Western European systems and therefore do not really fit into the overall structure of the CEE country where they are being established. Finally, the division of labour between trade unions and company level bodies of workers' participation is inappropriate. In short and to make the point: a consistent and coherent concept of the system of industrial relations is still lacking. This creates rivalry and suspicion, and, ultimately, weakens and de-legitimises the position of workers' representatives.

In sharp contrast to the deficiencies of the collective structures, an impressive volume of labour and social security legislation has been produced and continues to be produced in the CEE countries. This reflects the legalistic approach that is still commonly found in Central and Eastern Europe, whereby a problem is regarded as having been solved once a law has been passed to deal with it. As a result, a considerable gap remains between the

law on the books and day-to-day practice. There are many reasons for the lack of effective implementation, ranging from resentments against intervention on the basis of labour legislation to a lack of control and inefficiency of the existing judicial system for solving legal conflicts.

It has to be stressed that among a large number of small and medium-sized companies in the private sector of CEE countries, labour legislation plays no practical role whatsoever. It is made too easy for companies to sign contracts on the basis of general civil law and thus avoid the statutory provisions aimed at providing employees with some degree of protection. As a result, labour legislation is constantly de-legitimised. A further implication is the spread of a mentality that praises the free game of market forces in the absence of labour law and perceives as ideal the lack of collective structures.

In light of the above, it is difficult to deny that the structures needed for a functioning implementation of modern type Community legislation — of which the Working Time Directive is but one example — are not yet in place in the CEE countries. Whether the EU will be able to help build these structures is still an open question, but there are some indications that this may be the case.

The candidate countries have to transpose the *acquis* into their legal systems. This is only of limited use. The transposition as such is not the problem, as has been amply demonstrated by the screening process designed to monitor the conformity of the law of the candidate countries with Community law. The results of this screening sound very encouraging: the texts are perfect. However, this result is misleading. It totally neglects the dimension of implementation. There is a tremendous gap between the law on the books and the law in action. It is therefore important to refocus from formal compliance with the *acquis* to the construction of functioning patterns of industrial relations.

In this respect, there is one area where the Community's input may be extremely helpful: the topic of employees' involvement in management's decision making. There are three recent directives on this subject matter: the well known Directive on European Works Councils of 1994,[4] the Directive on Employees' Involvement in the European Company of 2001[5] and — most importantly — the Directive on a Framework of Information and Consultation within the Member States of 2002.[6] These directives not only indicate that the introduction of cooperative arrangements of

[4] Council Directive 94/45/EC of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees [1994] OJ L254/64.
[5] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute of a European company with regard to involvement of Employees [2001] OJ L294/22.
[6] Directive 2002/14/EC of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community [2002] OJ L80/29.

employees' involvement in management's decision making has become a mainstream strategy of the Community's social policy agenda, but they also eliminate the choice for old and new Member States of whether or not to put systems of workers' participation in place. Instead, they may only choose *how* to do this. In this regard, the directives are rather flexible. In sum, the Community's input in promoting patterns of information and consultation is an important step in the process of establishing functioning industrial relations in the new Member States.

However, the EU has no power to legislate in the area of collective bargaining. Collective bargaining is exclusively a matter for the Member States, increasing trends to coordinate collective bargaining policies among Member States by way of 'open method of coordination' (OMC) notwithstanding. The European social partners, the European Trade Union Confederation (ETUC) and the Confederation of the Industries of the European Community (UNICE), together with their affiliates in the present Member States of the EU, provide significant support in promoting collective bargaining structures in the CEE countries. However, results are likely to materialise only in the mid to long-term.

Another important impetus for strengthening domestic institutions in the new as well as the old Member States is the Charter of Fundamental Rights. The Charter was adopted at the summit in Nice in 2000 and has been integrated into the draft constitution for the European Union.[7] The Charter contains fundamental social rights, which reflect the social values on which the Community is based. They include collective rights. Moreover, the Charter insists on the responsibility of the EU and the Member States to provide job security, adequate working conditions, including considerations for workers' health, safety and dignity, and to protect precarious groups at work. They furthermore insist on measures to make family and professional life compatible and to provide social security as well as social assistance. Taken all together, it is pretty evident that these concepts are incompatible with simple deregulation, de-collectivisation and de-institutionalisation. To put it more broadly: it would be incompatible with a strictly neo-liberal approach. Thus, the Charter's chapter on 'solidarity' reconfirms the so-called 'European social model' and strengthens it. This also is an important message to the candidate countries where — as shown above — the ideology of pure individualism and anti-collectivism remains, for understandable reasons, very widespread. The fundamental social rights in the Charter, however, are only a guideline for a social policy agenda. Whether they will be merely symbolic or whether they will be a driving force for the construction of functioning patterns in the old and new Member States is an open question.

[7] Draft Treaty establishing a Constitution for Europe [2003] OJ C169/1.

The task remains to implement standards of labour law and social security law that on the one hand, take account of the Community's input and, on the other, fit into the cultural heritage and the overall framework of the CEE countries. It is the characteristic feature of the open method of coordination to respect national peculiarities, instead of striving for institutional convergence. This means a particular challenge for the new Member States. Or as Silvana Sciarra puts it in her brilliant paper: 'rather than entering a full-fledged system of hard and soft rules, they (the new Member States) are constantly required to contribute to its expansion'.[8] There is no ready-made system that could be imposed on the new Member States. For the project of the European social model to be further developed a joint effort is required. This is a 'continuous process of mutual learning', as Silvana Sciarra puts it. In this context comparative research is of utmost importance. I fully agree with Silvana Sciarra in her emphasis on the need for comparative legal analysis. Still, this might be too narrow a perspective, even if the research is conducted by 'enlightened scholars', as Otto Kahn-Freund long ago defined them. Comparative research will have to address not only the legal, but also the historical, the sociological and the economic dimensions. Therefore, what we need is a stronger interdisciplinary approach. This is difficult in light of the segmentation of legal scholarship and other scholarly disciplines, which — with the possible exception of the economic analysis of law — at least in Europe, seems to be increasing rather than decreasing. In this respect, the splendid seminar at the Columbia Law School, which initiated a dialogue not only among experts of different legal disciplines, but also with representatives of other scholarly fields, might become a model for future research.

[8] See Sciarra's contribution, ch 6.

10

Social Law at the Time of European Union Enlargement

A COMMENT BY ANTOINE LYON-CAEN

THE CONTRIBUTIONS OF Catherine Barnard, Csilla Kollonay Lehoczky and Silvana Sciarra all bring to light the problematic place of social law in the construction of European law and governance. The proper place for social law was uncertain from the beginning, if we recall that the founding Treaty of 1957 was reluctant to announce a social policy and did not define its modalities or direction.

At a time when the European Union is expanding, a process which undoubtedly is more significant in terms of policy than the preceding expansions, social law remains fragile. It appears that while it may be difficult to deny that the European construction owes to social law part of its inveterate originality, it remains impossible to reach a common agreement on the powers that should be given to European, as opposed to national institutions, and the responsibilities they should exercise.

To speak plainly, the persistence of this uncertainty, in which Silvana Sciarra sees a source of the marginalisation of European social law, should not be a surprise. It can be rationalised, even at the danger of oversimplification. The development and contents of social law indicate core values of the group — whether defined by national borders, polity, or the scope of a market. In Continental Europe, in particular, social law stands for a broad consensus that the market should not be considered the only legitimate form of coordination among individuals.

Nevertheless, the distinction between the market and other forms of coordination seems to be an integral part of the histories of European nation states. This may help explain the commonly observed 'nationalist syndrome' of social law experts, and the difficulty of conceiving the transposition of national experiences and practices to other Member States via EU level institutions.

The scope of European Union jurisdiction in the social sphere has always been questioned. The expansion of the Union is unlikely to reduce the precariousness of its claims. However, in her contribution to this volume,

Silvana Sciarra presents some new perspectives: she sees a possible consolidation of European social law. Her valuable opinion deserves discussion and will be addressed in Part II of this comment.

The perspective developments are partly based on the evolution of regulatory techniques. The question of the modes of action of the EU is a highly complex issue. Questions of terminology are not irrelevant to tackle this complexity, considering that when evoking, for example, concepts such as convergence, harmonisation, *rapprochement*, etc, we should ensure that they have the same meaning for everyone concerned. After all, to which object should the action called convergence, harmonisation, or *rapprochement* apply? Should it apply to rules, or institutions, or rather to the rules considered in the light of the results they are deemed to produce? Article 137 of the Treaty, for example, refers to the harmonisation of the 'social systems', suggesting contextual application and thus, a certain distance from both rules and institutions.

The three contributions invite a reflection on the regulatory techniques. And, if Csilla Kollonay Lehoczky's contribution is read in the light of that of Catherine Barnard, the eastward enlargement is likely to create new tensions (discussed below in Part I).

-I-

Catherine Barnard identifies a deep change in the conception of European social policy over recent years. While social policy used to be centralised, legalistic and devoted to harmonisation, a different model, one that is more decentralised, centred on apprenticeship, and focused on cooperation is currently being developed. This change is exemplified in the area of EU employment policies (and increasingly in other areas) as the open method of coordination (OMC) gains more ground, and is likely to be incorporated in the future Constitution. The most vigorous advocates of these developments point out three features of OMC, that are absent from other regulatory techniques, particularly in the doctrine of harmonisation. Specifically, OMC favours convergence over imposed unity, autonomy and exchange of information, experience over heteronomy, and fosters evaluation in lieu of sanctions. While at present, OMC may appear to be not more than an outline, the essential elements of this concept have been identified.

The development of OMC as a new governance device raises an important question, which is echoed in the contribution by Silvana Sciarra: is the OMC due to supplant the other regulatory techniques in the social sphere? Isn't its development the counterpart of the absence of normative competence of the Union? If the latter is the case, its development should be conceived only as additive to the other regulatory techniques.

The reading of the three contributions together reveals another issue, namely the reception of the European regulatory techniques by the new Member States. If we consider the distinction that Catherine Barnard draws between a 'legalistic approach' and a 'regulatory learning approach', the OMC would indeed be the archetype of the latter.

At first sight, the new Member States are well prepared for the legalistic approach. They have a long history of and strong familiarity with a highly legalistic approach, which is evidenced in the official analysis presented at the end of the pre-accession period. In the new Member States, the 'process of legislative approximation' can therefore be considered a success. In other words, they have not encountered considerable difficulties in ensuring that their legislation complies with European law.

It must be acknowledged, however, that observing formal compliance leaves the essential problems unresolved. How can the addressees of the norms, the social actors, enterprises, workers, etc 'mobilise' these norms, whose elaboration owes more to the concern for the respect of European requirements than to an analysis of labour markets and industrial relations in their own countries? We do not suggest that the establishment of models originating from Europe will have no effect; it is, however, reasonable to expect that it is likely to engender unforeseen effects. Csilla Kollonay Lehoczky is undoubtedly justified in attracting attention to the gap between legal discourse and social conditions. After all, 'mobilising' norms is one thing, their implementation is another. Among others, it requires an appropriate institutional infrastructure.

The importance of institutions is even more appreciable when considering the second approach. For the regulatory learning approach to exist as an independent mode of action, it requires a number of preconditions. Two categories can be distinguished. The first refers to the relevant actors. In order to foster the learning model, each national system should have strong organisations that represent the interests of workers, on the one hand, and those of entrepreneurs on the other. Further, these organisations should be endowed with important resources, including cognitive resources. In an ideal representation of the learning approach, one cannot take for granted that actors will be stable and immutable. In contrast, social evolution will bring about reconfigurations. This in turn requires the participation of collective actors. Other requirements should be added, such as a true system of production and management of norms. Such a system consists of a plurality of sources and different levels of communication and articulations among them.

Let us stop here. Indeed, it is not necessary to discuss further the contents and rationality of a regulatory learning approach, considering that it is quite apparent that the new Member States are not prepared for it.

-II-

At first sight, the debates within the Convention on the Future of Europe, whose task was to prepare a draft Constitution, have not helped to solve the ambiguity with respect to European social law. On the one hand, the desirability of a Europe that is more socially progressive has been asserted, even though the success of this expression is largely due to remarkable polysemy. In the final draft that was adopted by the Convention and presented to the European Council on 20 June 2003, the objectives of the Union include real social ambitions. Its development is said to be based on a social market economy, highly competitive and aiming at full employment and social progress, and with a high level of protection and improvement of the quality of environment.

The statement is an illustration of the conflicting inspirations to which Europe is accustomed, with a special tribute to Germany and its model of a social market economy. The draft Constitutions also mandates that the Union shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations and protection of children's rights.

The general provisions could thus be examined closely and other expressions with similar social exaltations might be found. However, one should not focus only on these aspect of the draft Constitution, as there is a flip side to them. And this is the utmost circumspection with which the text of the Convention addresses European social policy. Social policy constitutes, indeed, the only domain of shared competence between the Union and the Member States. Circumscribing the competences of the EU in this fashion amounts to a restriction of its powers. Moreover, even to the extent the coordination of social policies is contemplated, the language remains highly discretionary in mandate (ie, the text provides that 'the Union may'); and contents (ie, the text provides that the EU may 'adopt initiatives' — without defining the nature of these initiatives).

Limiting the analysis to these provisions, which at present are merely the fruits of the Convention's work and by no means binding, one may conclude that European social policy is likely to remain generous in its aims, but restrictive as far as practical implementation is concerned. Therefore, one should, now more than ever, be mindful of the three main ways in which the Europeanisation of social policies may take place; a bottom up mutual learning approach, the legalistic approach, and the OMC.

The first method is entirely dependent on the actors of the labour markets and those of industrial relations. It is that of the Europeanisation process which takes place through borrowing, imitation or mimicry, and through the tactical or strategic use of comparison by the major social actors, the labour markets and labour organisations on the one hand, and employer organisations on the other. It is very difficult to predict whether,

in the new Member States, similar processes will emerge, and when. However, the forces of latent Europeanisation in this fashion should not be underestimated. Indeed, a growing literature is devoted to documenting and interpreting these trends.

The second path, the legalistic approach, is less complex to study and address effectively. Its dynamics rest on the effects of European law. Experience shows that European law, in its traditional forms (directives on collective dismissal, transfer of undertaking, etc) as well as in its old but evolutionary components (equality between women and men, health protection at work), has effects that the promoters of European action cannot foresee. Thus, to take a single example, the consolidation of the policy of equality between women and men has generated here and there, a strong development of a claim, sometimes successful, for the equal treatment of female and male workers.

To address and understand these effects, which are induced by EU law, a closer familiarity with the different legal systems of EU Member States and their functioning is essential. In fact, such a deeper understanding could help overcome some of the dogmatism that currently characterises much of the debate.

The third path leaves more space to processes. It is the one which Catherine Barnard calls the 'learning regulatory approach', which is represented by the OMC. As has been stated, this approach requires a fairly stable, organised system of industrial relations in the different Member States. However, one should also be sensitive to other aspects of the OMC. It gives considerable, if not exclusive, weight to the assessment of conditions using the language of statistics. However, the logic of the categories construed in this language is neither explained, nor discussed by those to whom the information is delivered and whose actions are guided by the results of the data analysis.

One may even take a step further and remark on the contradiction between the claim of establishing a learning process, and the preeminence given to expert knowledge and interpretation of quantitative data. To ensure the proper functioning of the OMC in the context of future European social policies, it seems indispensable that all relevant parties fully understand the meaning and power of concepts and tools that are used for policy analysis and policy formulation. It is here that the proposed integration of the European Charter on Fundamental Rights into the new Constitution could one day prove its merit. Fundamental rights are, indeed, capable of constituting references to guide the normative evolution, to build a unity beyond the diversity of institutions and organisations — a unity that would not be limited to making diversity tolerable, and to underline its virtues, but that would allow the justification of public or collective interventions. In short, fundamental rights could be the reference point for evaluating actions

(for appraising their value) and provide the much needed reflexivity to the processes of Europeanisation of social law which at present, is lacking.

The extent to which the described three approaches result in institutional change, and perhaps convergence of European labour and social law, should be investigated by means in comparative research.

Part III

Corporate Governance

11

The EU Model of Corporate Law and Financial Market Regulation

PETER DORALT AND SUSANNE KALSS

INTRODUCTION

THE PURPOSE OF this chapter is to give an overview of the current state of European law and its likely future trends in the area of corporate law and financial market regulation. The primary and secondary EU law as it currently exists is part of the a*cquis communautaire*, which the new Member States had to adopt in order to be admitted to the EU. Moreover, future trends will shape the law of the new Member States as they, just as current Member States, will be bound by it. As this contribution will demonstrate, the EU has substantially changed its goals with regard to the harmonisation of corporate law and financial market regulation. Although the basic assumption that a common market requires common rules still holds, comprehensive harmonisation aspirations have increasingly given way to more flexible approaches to harmonisation. With regard to financial market regulation, greater emphasis is placed on self-regulation as opposed to state (or EU) regulation. An important implication is that greater flexibility allows individual Member States greater degrees of freedom to shape their own domestic law.

Corporate law and financial market law fall within the scope of the fundamental freedoms guaranteed by the Treaty of the European Union (TEU),[1] especially the freedom of establishment (Article 43), the freedom of movement of services (Article 48) and of capital (Article 56). The legal authority for the European Community in the area of corporate law and securities regulation can be found in the objective of creating a common market as stated in the Treaty. The guiding principles of the fundamental freedom of establishment, free movement of services and capital, as well as secondary law grant the EC legislative authority over matters related to the

[1] Consolidated Version of the Treaty on European Union, OJ L C325/33 of 24 December 2002.

internal market. The rules dealing in detail with corporate and securities matters are considered to be part of a wider project aimed at establishing a single market and at creating 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured' (Article 14).

Article 43 prohibits restrictions on the freedom of establishment by nationals from one Member State in the territory of another Member State. This freedom applies not only to natural persons, but also to companies that were formed in accordance with the law of a Member State and have their registered office, central administration, or principal place of business within the Community. Article 43 extends the freedom of establishment to the creation of agencies, branches or subsidiaries thereby giving these entities the same status as the parent company.[2]

Article 56 prohibits any restriction of the movement of capital among Member States and third countries. As specified in the Treaty and several directives designed to implement the Treaty objective, free movement of capital includes cross-border holdings in partnerships or corporations. The major difference between the freedom of establishment and the free movement of capital is that the latter is indifferent to the nature of the capital investment.

These two freedoms form the basis for secondary regulation. The two pillars, freedom of establishment, and free movement of capital, are at the core of EC corporate law. They are complemented by the free movement of services and free access to domestic markets of Member States, which is of particular importance to the financial services industry.

The European legislator utilizes various legal instruments to shape corporate and financial services law, namely directives, regulations, and recommendations. In addition, international agreements among Member States have been employed. Directives are binding on Member States, which are then required to transpose European law into domestic law. By contrast, regulations are directly applicable, and thus do not require implementation by national legislatures, even though implementing regulations may be required to operationalise the European rules within the domestic legal framework. In practice, the difference between regulation and directive is negligible as both instruments leave some room for national legislators. The two regulations establishing the European Economic Interest Group[3] as

[2] Case –270/83 *EC Commission v French Republic* [1986] ECR 273; E Werlauff, *European Company Law* (Copenhagen, Jurist- og Økonomforbundets Forlag, 1993) 17 ff; W Schön, 'The Concept of the shareholder in European Company Law' (2000) *European Business Organization Law Review* 3, 12; W Schön, 'Freie Wahl zwischen Zweigniederlassung und Tochtergesellschaft — ein Grundsatz des Europäischen Unternehmensrechts' (2000) *Europäisches Wirtschafts- und Steuerrecht* 281.

[3] Council Regulation (EEC) 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG) [1985] OJ L199/01.

well as the European Company[4] may be cited as an example. Sometimes the European legislator utilises recommendations to promote a common understanding of soft law or proposals for directives, which have not been adopted yet. For several years Brussels has pursued a new approach of law making, the so-called *multi-layer framework*:[5] directives and regulations adopted by the Council will be limited to establishing principles and general rules. The Commission advised by special committees consisting of representatives of national bodies or experts, will be in charge of adopting detailed implementing rules. This approach should increase the flexibility of law making at the EU level as well as for domestic law makers.

The development of corporate law and financial market regulation, although closely linked,[6] have taken different paths in the history of EU law, which in turn is related to the history of the European Community and its objectives: at the end of the 1950s and the beginning of the 1960s, the community consisted of only six Member-States, Belgium, France, Germany, Italy, the Netherlands, and Luxemburg. These continental European countries had corporate governance systems in place that relied less on equity markets and more on bank financing. Not surprisingly, they focused their ambition to create an economic community first on issues familiar to them, such as corporate law, and delayed attempts to harmonise the rules governing financial markets. As early as 1959, a proposal to create a European Company was presented.[7] The very first attempt to harmonise national corporate law was presented by the Commission in 1964[8] and focused on the disclosure requirements for companies at the time of their establishment, the legal representation of the company and the conditions for voiding corporate transactions and the establishment of the corporation itself.[9]

[4] Council Regulation (EC) 2157/2001 of 8 October 2001 on the Statute for a European company (SE) [2001] OJ L294/01.

[5] For financial market regulation in particular, see section below on New Techniques of Rule Drafting.

[6] See for the perspective of *some European countries:* P Davies, *Gower´s Principles of Modern Company Law* 7th edn (London, Thomson/Sweet & Maxwell, 2003); PO Mülbert, *Aktiengesellschaft, Unternehmensgruppe und Kapitalmarkt* (Munich, Beck, 1995); S Kalss, *Anlegerinteressen — der Anleger im Handlungsdreieck von Vertrag, Verband und Markt* (Vienna, Springer, 2001).

[7] C Sanders, 'Auf dem Weg zur einer Europäischen Aktiengesellschaft' (1960) *Recht der Wirtschaft* 1 ff; see also KJ Hopt, 'Europäisches Gesellschaftsrecht — Krise und neue Anläufe' (1998) *Zeitschrift für Wirtschaftsrecht* 96, 99.

[8] Proposal of the first directive of Company Law [1964] OJ 3245; V Edwards, *EC Company Law* (Oxford, Clarendon Press, 1999) 16.

[9] It should be noted that already at the beginning of the 19th century, proposals were made for the harmonisation of corporate law in order to facilitate transactions across Europe. See F Klein, *Die neueren Entwicklungen in Verfassung und Recht der Aktiengesellschaft* (Vienna, Manz, 1904) 54; also S Kalss, Ch Burger and G Eckert, *Die Entwicklung des österreichischen Aktienrechts — Geschichte und Materialien* (Vienna, Linde, 2003) 27.

Attempts to liberalise the movement of capital were made fairly early.[10] However, at the time there was little support for these actions, despite significant persuasion efforts by experts.[11] Capital markets were extremely fragmented and Member States were reluctant to give up financial sovereignty and permit foreign market participants access to their national markets. The Segré-Report 'Development of a European Capital Market' stressed the importance of having reasonably homogenous information on securities traded in other markets available to investors. In response, the Commission recommended a threefold disclosure regime: prospectus for public offers, mandatory disclosure upon listing at the stock exchange and continuing disclosure obligations.[12] Although the instruments and techniques for liberalising the European Capital Market were well known, analysed and explained already during the first stage, it took many more years to recognise the importance of financial market regulation and its interaction with company law, and to adopt the relevant directives at the European level.

CORPORATE LAW

General Remarks

European corporate law is far more than the simple sum of corporate laws of individual Member States.[13] The legal term '*European Corporate Law*' comprises four aspects: (i) Harmonisation of national corporate law, focusing primarily on publicly held corporations, and — to a smaller extent — on closely held, or private corporations; (ii) the mutual recognition of national companies, an aspect that has been particularly stressed by the European Court of Justice (ECJ)[14] as we will further discuss below; (iii) the establishment of a legal framework that enables national companies to move from one Member State to another (ie by way of transfer of domicile or cross-border merger) without incurring substantial transaction costs;

[10] Above Edwards, n 8 at 228 ff.
[11] Cf the famous *Segré*-Report 1966, below n 80.
[12] Above Edwards, n 8 at 229.
[13] W Ebke, 'Unternehmensrechtsangleichung in der Europäischen Union — Brauchen wir ein European Law Institute' in U Hübner and W Ebke (eds), *Großfeld — Festschrift* (Heidelberg, Verlag Recht und Wirtschaft, 1999), 189, 200; W Schön, 'Mindestharmonisierung im europäischen Gesellschaftsrecht' (1996) *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* 221, 249; S Kalss, Ch Burger and G Eckert *Entwicklung des österreichischen Gesellschaftsrechts — Geschichte und Materialien* (Vienna, Linde, 2003) 28.
[14] Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459; Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH* [2002] ECR I-9919; Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd*. This judgment of 30 September 2003 is not yet published in ECR, but is available at <http://curia.eu.int> (5 March 2004).

and (iv) the creation of companies governed by supranational rather than national law, such as the European Interest Group and the European Company (the Societas Europaea, the 'SE').[15]

The core provision for the harmonisation of corporate law within the EU is Article 44 paragraph 2 of the Treaty. It establishes the EC's legislative authority for coordinating, to the extent necessary, any safeguards which are required of companies by Member States for the protection of the members (shareholders) and others (ie creditors and other stakeholders), with a view to making such safeguards equivalent throughout the Community. In other words, the protection of stakeholders in domestic corporate law is taken as a given. In fact, some argue that Member States even have a legal duty to protect shareholders.[16] The coordination of safeguards throughout the Community shall ensure that investors find at least a common minimum level of protection in other Member States. Moreover, legal harmonisation also serves the purpose of ensuring that companies can in fact exercise the freedom of establishment and free movement of capital by forcing Member States to abandon provisions that impede the freedom to enter their markets.

Harmonisation Versus National Diversity

European company law is subject to the principle of subsidiarity laid down in Article 5 of the Treaty. According to this principle, the European Union is entitled to act and initiate legislative measures only if unified regulation is deemed necessary for the advancement of the single market and of the legitimate objectives of the Commission in that area, and that the same results cannot be achieved absent European intervention. The dispute surrounding the precise meaning of Article 5 of the Treaty notwithstanding,[17] it is now widely held that the provision is rather open-ended and its significance should therefore not be overstated. The principle of subsidiarity supports the view that company law should not be harmonised comprehensively. The matters that should be regulated at the European level cannot be determined purely on the basis of the abstract principle of removing national barrier protections of key stakeholders, to guard against the breakdown of markets. Instead, the relevant issues should be identified on a case-by-case basis to determine

[15] M Lutter, *Europäisches Unternehmensrecht* 4th edn (Berlin, de Gruyter, 1996) 4.
[16] W Schön, 'The Concept of the shareholder in European Company Law' (2000) *European Business Organisation Law Review* 3 at 14.
[17] With respect to corporate law: W Schön, 'Gesellschaftsrecht nach Maastricht' (1995) *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 1; W Schön, above n 13 at 221, 228.

whether harmonisation is indeed necessary to achieve the common market objective.[18]

Apart from the principle of subsidiarity explicitly included in the Maastricht Treaty of 1992, it has become increasingly apparent that comprehensive harmonisation of corporate law is neither realistic nor desirable.[19] From the very beginning of the harmonisation process, the measures that were adopted have found critical review for legal as well as political reasons.[20] Overall, the development of this body of law can be characterised as a steady stop-and-go.[21] The enlargement of the community and the rising number of Member States has made it more difficult to find common ground — a trend that is likely to be aggravated when the 10 new Member States will join the EU in 2004. While some observers describe the harmonisation of company law as a success story and one of the most advanced fields of European private law,[22] others have pointed to the difficulties encountered in the process of harmonisation and have even detected signs of a serious crisis.[23]

The permanent questioning of the extent of harmonisation and the level at which it should take place continue to shape the discussion about the efforts of creating European corporate law. The pros and cons oscillate between far-reaching harmonisation on the one hand, and regulatory competition among national law makers and regulators on the other.[24] Neither the 'harmonisation wing' nor the 'competition wing' is quite convincing however. Harmonisation is not an objective in itself,[25] but only a tool to

[18] M Habersack, *Europäisches Gesellschaftsrecht* (Munich, Beck, 2003) 23, Nr 22-23, 58, Nr 74 ff; G Schwarz *Europäisches Gesellschaftsrecht* (Nomos, Baden-Baden, 2000) 75; more generally G Lienbacher in Schwarze (ed), *EU-Kommentar* (Nomos, Baden-Baden, 2000) Art 5 EGV 266, Nr 23.

[19] KJ Hopt, 'Kapitalmarktrecht und Aufsicht über Kapitalmarktintermediäre' in S Grundmann (ed), *Systembildung und Systemlücken in Kerngebieten des Europäischen Privatrechts* (Tübingen, Mohr, 2000), 307, 309.

[20] R Buxbaum and KJ Hopt, *Legal Harmonisation and the Business Enterprise* (Berlin, de Gruyter, 1988).

[21] KJ Hopt, 'Europäisches Gesellschaftsrecht — Krise und neue Anläufe' (1998) *Zeitschrift für Wirtschaftsrecht* 96 ff; KJ Hopt, 'Harmonisierung im europäischen Gesellschaftsrecht' (1992) *Zeitschrift für Gesellschaftsrecht* 265, 268.

[22] P Hommelhoff, 'Zivilrecht und der Einfluss europäischer Rechtsangleichung' (1992) *Archiv für civilistische Praxis (AcP)* 71 ff.

[23] P Behrens, 'Krisensymptome in der Gesellschaftsrechtsangleichung' in U Immenga (ed) *Festschrift Mestmäcker* (Nomos, Baden-Baden, 1996) 831.

[24] See KJ Hopt, 'Europäisches Gesellschaftsrecht — Krise und neue Anläufe' (1998) *Zeitschrift für Wirtschaftsrecht* 96, 98; S Grundmann, 'Regulatory Competition in European Company Law — Some different Genius?' in G Ferrarini, KJ Hopt and E Wymeersch (eds), *Capital Markets in the Age of the Euro* (The Hague, Kluwer, 2002) 581, 567; W Ebke 'Unternehmensrecht und Binnenmarkt: e pluribus unum' (1998) *RabelsZ* 197, 207 ff; EM Kieninger, *Wettbewerb der Privatrechtsordnungen im Europäischen Binnenmarkt* (Tübingen, Mohr Siebeck, 2002) 26 ff, 40, 360 ff.

[25] Above Buxbaum and Hopt, n 20; above Schön, n 13 at 238, 249.

facilitate the development of the single market and to provide a reliable legal framework for economic undertakings. In Europe, competition among national law makers has never been regarded as a sound strategy, as this was widely associated with a race to the bottom.[26] Moreover, contrary to the assertions of opponents to harmonisation, the process of harmonisation does not necessarily suffocate regulative competition, but may actually support and stimulate it.[27]

The European law maker has taken various measures to ensure that harmonisation does not eliminate variation at the national level. Notably, the Commission's White Paper 'Completing the Internal Market' of 1985 replaced the goal of comprehensive harmonisation in corporate law in favour of concepts, such as equivalent rules and regulations and mutual recognition.[28] Secondly, the Financial Services Action Plan of 1999[29] explicitly states the stimulation of regulatory competition among the Member States as its regulatory objective. Finally, the ECJ has supported regulatory competition by handing down the *Centros* decision in 1999, which denies domestic regulators the right to deny market access on the grounds that a company was incorporated in another Member State only to avoid domestic regulations.[30] The decision of the Court was confirmed by a recent ECJ ruling, *Überseering — BV*.[31] Although the *Centros* Judgement focused on the interpretation of the Treaty provisions regarding the right of establishment, the decisions of the Court may be interpreted to have much greater impact.[32] According to the opinion of Advocate General La Pergola, in the absence of harmonisation, regulatory competition among legal systems should develop freely, including in corporate matters. The Court made it clear that at the very least, the full realisation of the freedom of establishment and the free movement of capital will not wait until comprehensive harmonisation has been accomplished, but that the relevant Treaty provisions will be enforced against restrictive domestic law. Thus, the European Court has assumed the role of a catalyst for the most recent development of European corporate law.

[26] Above Ebke, n 24 at 197 ff; Above Grundmann, n 24 at 561, 567.
[27] Above Hopt, n 19; Above Grundmann, n 24 at 561, 567.
[28] Completing The Internal Market: White Paper From The Commission To The European Council COM (1985) 310 (28/29 June 1985) n 67 ff, 77.
[29] Implementing the framework for financial markets: Action Plan COM (1999) 232 (11 May 1999).
[30] Case C-212/97, above n 14.
[31] Case C-208/00, above n 14.
[32] EM Kieninger, 'Niederlassungsfreiheit als Rechtswahlfreiheit' (1999) *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 724 ff; F Munari and P Terrile, 'The Centros Cases and the Rise of an EC Market for Corporate Law' in G Ferrarini, KJ Hopt and E Wymeersch (eds), *The Capital Markets in the Age of the Euro* (The Hague, Kluwer, 2002) 528, 539; H Merkt, 'Centros and Its Consequences to Member State Legislatures' (2001) *International and Comparative Corporate Law Journal* 119, 124 ff.

The Status of Harmonisation

Achievements

Harmonisation has come in different stages and has focused — in chronological order — on the protection of creditors, on the structure and organisation of the corporation, and finally on the observance of the interests of investors, including both shareholders and creditors.[33]

During the first period of harmonisation, priority was placed on the protection of outside stakeholders who were not part to the corporate contract, such as creditors and employees. The first directive[34] used disclosure requirements to ensure that creditors, in particular, had sufficient access to information about the company they were lending to and the management personnel they interacted with. The second directive[35] deals with the formation of the company and capital maintenance of the publicly traded corporation. The accounting directives (4th, 7th, 8th directives on company law) may be regarded as outstanding achievements of the Community to improve and harmonise accounting and disclosure standards by reconciling different approaches to accounting regulation. However, these achievements are now being superseded by international harmonisation efforts, which the EU has endorsed.[36]

Regarding the organisation and structure of the corporation, the directives on company mergers and split-ups harmonise — at least for public companies — the law for domestic merger transactions, but fail to address cross-border transactions. The directives on single member corporations as well as the so-called branch directive, ensure the right of a single person to incorporate her business and establish conditions for opening a branch in another Member State. Finally, several directives seek to protect the interests of equity investors. Some of the directives already mentioned belong to this category, such as the disclosure rules found in the first directive and those dealing with accounting and disclosure of the annual reports. In addition, several directives that were designed to

[33] M Lutter, 'Das europäische Unternehmensrecht im 21. Jahrhundert' (2000) *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 1 ff.
[34] First Council Directive 68/151/EEC on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Art 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community [1968] OJ L65/8; cf Directive 2003/58/EC amending Council Directive 68/151/EC, as regards disclosure requirements in respect of certain types of companies [2003] OJ L221/13.
[35] Second Council Directive 77/91/EEC on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Art 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent [1977] OJ L26/1.
[36] M Habersack, *Europäisches Gesellschaftsrecht* (Munich, Beck, 2003) n 289 ff.

facilitate the integration of financial markets should be listed here, such as the listing particulars directive,[37] the continuing disclosure duties (including ad-hoc disclosure and the disclosure of major holdings), the insider trading directive,[38] the prospectus directive,[39] and the proposed transparency directive.[40]

Failures

To complete the picture, several failed attempts at harmonising EC company law should be mentioned as well, including the 5th directive on co-determination and other matters concerning board structure and the allocation of rights and responsibilities among different corporate 'organs', the draft directive on company groups, the proposals dealing with the transfer of domicile, and the cross-border merger directive, which have not yet been adopted. In fact, some of the directives have been — at least for the time being — withdrawn by the Commission. Finally, the takeover directive was stopped in a spectacular action by the European Parliament in 2001 and efforts by the Commission to resuscitate the directive have been in vain for some time. Recently an agreement has been reached and the Commission published a proposal for a Directive on takeover bids,[41] which is expected to be finally released in the first quarter of 2004.[42]

These failures allude to the fact that national barriers are often too strong to be overcome. The process of negotiating sessions lasting a day or two with representatives from national governments being flown into Brussels in the morning and leaving in the evening does not appear to provide adequate solutions to difficult legal questions. Influential Member

[37] Council Directive 80/390/EEC of 17 March 1980 coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing [1980] OJ L100/1.
[38] Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing [1989] OJ L334/30.
[39] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L345/64; cf also CESR's Advice on Level 2 Implementing Measures for the Prospectus Direcitve, CESR/03-399; CESR Prospectus Consultation Feedback Statement, CESR/03-300; CESR/03-494; CESR/03-495; CESR/03-496, <http://www.europefesco.org/v2/default.asp> (10 March 2004); and the ESC documents ESC/42/2003 Rev 2; ESC 04/2004 Rev 1 and other documents to the Prospectus Directive, <http://europa.eu.int/comm/internal_market/en/finances/mobil/prospectus_en.htm> (10 March 2004).
[40] Proposal for a Directive on the harmonisation of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, COM (2003) 138 final.
[41] Proposal for a a Directive of the European Parliament and of the Council on takeover bids, COM (2002) 534 final, [2003] OJ C45 E/1.
[42] Krause, 'BB-Europareport: Die EU-Übernahmerichtlinie — Anpassungsbedarf im Wertpapiererwerbs- und Übernahmegesetz' (2004) *Betriebs-Berater* 113.

States frequently use dead-locks during negotiations to link the issue at hand with a matter from a completely different sector. An example is the horse-trading that took place during negotiations on defensive measures in takeovers and labour law issue, such as restrictions on working-hours.[43]

Moreover, highly politicised issues, such as co-determination of employees on the board have repeatedly stalled the process of company law harmonisation. Furthermore, sometimes harmonisation succeeds where there seems to be little demand for it. An example is the regulation of the European Economic Interest Group, which enjoys a shelf life, but has not been accepted by the markets.[44]

Significance of the Regulation on the European Company

A major achievement in the creation of common rules for a common market, which deserves to be analysed in more detail, has been the adoption of the Regulation of the European Company in 2001.[45] The creation of this new legal vehicle for companies should stimulate other harmonisation projects. The history of the European Company dates back to the very beginning of the Community, but shall not be repeated here.[46] The political breakthrough at the summit of Nice in December 2000 was implemented in two legal acts: (1) the 'Regulation of the Council on the Statute of the Societas Europaea'[47] and (2) the Directive of the Council supplementary to the Statute of the SE in regard to worker participation. [48]

The regulation does not create an independent set of rules for the SE, but combines existing community law, domestic law of the Member States, some new rules, and finally the articles of association (statute) of the SE as drawn up by its founders.[49] Thus, there is no single form for the SE, but rather a variety of different forms based on the domestic law of the Member States.[50] As a result, at the time the SE regulation will enter into force (ie in October 2004 when Member States will have transposed the directive on employee participation in the SE), there will be potentially 25 different

[43] See for the example, F Guerrera and B Jennen, 'Germany and UK in joint bid for tougher takeover plans' *The Financial Times* (London, UK, 3 February 2003) 1.
[44] Lutter above n 33, at 8.
[45] Council Regulation on the Statute of a European company, see n 4 above.
[46] See Schwarz, *Europäisches Gesellschaftsrecht* (Nomos, Baden-Baden, 2000) 643 ff.
[47] Council Regulation (EC) 2157/2001 on the Statute for a European company (SE) [2001] OJ L 294/1.
[48] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees [2001] OJ L294/22.
[49] Schwarz, *Europäisches Gesellschaftsrecht* (Nomos, Baden-Baden, 2000) 647 ff; P Hommelhoff, 'Einige Bemerkungen zur Organisationsverfassung der Europäischen Aktiengesellschaft' (2001) *Die Aktiengesellschaft* 279 ff.
[50] Lutter, 'Europäische Aktiengesellschaft — Rechtsfigur mit Zukunft?' (2002) *Betriebsberater* 1 ff.

types of SEs, based on the mandatory rules of the different Member States alone, and of course many more with regard to provisions that are optional.[51] The regulation is not a detailed legal basis but rather a framework, which leaves space for national creativity. To be sure, Article 9 of the SE regulation refers to the law of the publicly held corporation, which was at the centre of the harmonisation programme so far. However, as pointed out above, the scope of harmonisation affects only some areas of corporate law (corporate structure, minority rights), and leaves others to the discretion of the Member States. The possibility of 25 different types of the European Company may well create restricted competition among the national legislators.[52]

Apart from the psychological effect that an important and ambitious project of harmonisation has finally been realised, the adoption of the regulation is likely to promote the development of European corporate law as a whole. Two important issues should be mentioned here: (1) The establishment and migration of corporations across national borders, including rules governing the transfer of domicile; and (2) the internal governance structure, in particular the choice between one-tier and two-tier management boards.

An SE is created, in principle, by at least two corporations incorporated under the law of different Member States.[53] This creates the need to harmonise the law — at least to a certain extent. Moreover, measures should be taken to ensure that the responsible authorities are working closely together to avoid any flaws in the registration procedure. In addressing these issues, the SE regulation paves the way for two other important pieces of European corporate law, which had already been proposed by the Commission several years ago: the proposals for directives dealing with the transfer of domicile[54] and cross-border mergers.[55] The Commission

[51] A Arlt, C Bervoets, K Grechenig, S Kalss, 'The *Societas Europea* in Relation to the Public Corporation of Five Member States (France, Italy, Netherlands/Spain, Austria)' (2002) *European Business Organization Law Review* 549, 552.

[52] Grundmann, above n 24 at 562, 565; C Teichmann, 'Die Einführung der Europäischen Aktiengesellschaft. Grundlagen der Ergänzung durch den deutschen Gesetzgeber' (2002) *Zeitschrift für Unternehmens- und Gesellschaft* 383, 400; Above A Arlt, C Bervoets, K Grechenig, S Kalss, n 51.

[53] For the different requirements to found a SE see P Hommelhoff, 'Einige Bemerkungen zur Organisationsverfassung der Europäischen Aktiengesellschaft' (2001) *Die Aktiengesellschaft* 279 ff.

[54] G Di Marco, 'Der Vorschlag der Kommission für eine 14. Richtlinie' (1999) *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 3 ff; K Schmidt, 'Sitzungsverlegungsrichtlinie, Freizügigkeit und Gesellschafsrechtspraxis' (1999) *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 20 ff; HJ Priester, 'EU-Sitzverlegung — Verfahrensablauf, Zeitschrift für Gesellschaftsrecht' (1999) *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 36.

[55] For the latest version of this draft directive compare the proposal for a Directive on cross-border mergers of companies with share capital, Brussels 18 November 2003 COM (2003) 703 final, 2003/0277 (COD).

has already begun to revive negotiations on the existing proposals with representatives from national governments and legislative departments. A number of important questions will need to be addressed before these directives can be approved: should the cross-border merger be restricted to public corporations or should private corporations be covered as well? In case private companies were to be included, the existing directive on domestic mergers, which applies only to publicly held corporations, would have to be reconsidered. The rules dealing with the transfer of domicile could be addressed within the context of cross-border mergers as well. The greater the diversity between domestic law governing merging companies, the more sophisticated the rules governing the transfer of domicile and cross-border merger must be, as they have to create an interface between the legal systems of the companies involved in the merger.[56]

Under Article 38 of the SE regulation, the *founders* of the SE have the choice between a two-tier management structure consisting of a management and a supervisory board, and a single-tier management structure. This choice is available irrespective of whether the SE is subject to employee co-determination or not. Under the companion directive on employee participation in the SE, each domestic legislature as well as each company will have to address the problem of incorporating employee participation in companies that adopt a single-tier management structure without rendering managerial decision-making so difficult as to threaten the capacity of the SE to compete in the market. Again, the need to find solutions to this problem may stimulate competition among domestic legislatures within the existing framework of European company law.[57]

Economic Challenges

The European economy currently faces several challenges, such as: accelerating innovation and progress in information and communications technology; rising mobility and internationality of market participants; globalisation of the trading in securities; increasing importance of equity

[56] Even in absence of such rules, cross border mergers can and do take place, but that frequently domestic law increases transaction cost and much is asked of the law firms that design the merger transaction. Examples in the past within the European Union are the Daimler/Chrysler merger — T Baums, 'Corporate Contracting Around Defective Rules' (1999) *Journal of Institutional and Theoretical Economics* 119 ff; N Horn, ' Internationale Unternehmenszusammenschlüsse' (2002) *Zeitschrift für Wirtschaftsrecht* 473 ff — or the merger between the German Hypo Vereinsbank and the Austrian Bank Austria — F Khol and M Binder, 'Bankenehe Hypo Vereinsbank und Bank Austria — Kurzanalyse' (2000) *ecolex* 875 ff; D Weber-Rey and BG Schütz, 'Zum Verhältnis von Übernahmerecht und Umwandlungsrecht' (2000) *Die Aktiengesellschaft* 325 ff.

[57] See section below, Economic Challenges.

financing accompanied by the creation of new financial products and investment strategies; extensive policy and regulatory activities to facilitate cross-border capital flows and market access (introduction of the Euro).[58] Additionally, there is a deep crisis and lack of confidence in capital markets and trustworthiness of companies as agents of economic prosperity. The main cause for this crisis may be exaggerated expectations in the past. However, a series of scandalous bankruptcies, embezzlement, and fraud by accountants, managers and board members, all indicators of poorly operating corporate governance systems, have exacerbated this problem.[59]

The European legislator will have to react to these challenges and try to find ways to adapt the legal system to provide an adequate framework for this changing environment. In fact, European corporate law is currently in flux. First, during the past decade, the separation of rules governing private corporations and public corporations, in particular those with publicly listed securities, has deepened.[60] Corporations with publicly traded and listed shares are to a much greater extent exposed to international competition that results from the integration of financial and product markets. This creates demands to lower legal barriers by way of standardizing the rights embodied in shares, the organisational structure, and, more broadly, the corporate governance system of these companies[61] as opposed to privately held corporations. Whereas for publicly listed and traded companies the harmonisation is widely regarded as a prerequisite for the functioning of the single market, the private companies could be left to the national legal systems insofar as third parties will not be affected in a negative manner and will not suffer any disadvantage.[62] The ruling of the ECJ in *Centros* was a clear endorsement of national

[58] H Baum, 'Capital Markets and Possible Regulatory Responses' in J Basedow and T Kono (eds), *Legal Aspects of Globalisation* (The Hague, Kluwer, 2000) 78; S Kalss, 'New Challenges for Stock Exchanges, investment firms and other market participants' in J Basedow, H Baum, K Hopt, H Kanda and T Kono (eds), *Economic Regulation and Competition* (The Hague, Kluwer, 2002) 111, 113.

[59] 'Insert steel' *The Economist* (London, UK, 11 January 2003) 13; E Wymeersch, 'Factors and Trends of Change in Company Law' (2000) 4 *International and Comparative Corporate Law Journal* 481–501.

[60] Schön, 'Das Bild des Gesellschafters im europäischen Gesellschaftsrecht' (2000) *RabelsZ* 1, 6; W Schön, 'The Free Choice between the Right to Establish a Branch and to Set up a Subsidiary — A Principal of European Business Law' (2001) *European Business Organization Law Review* 339–64; M Lutter, 'Konzepte, Erfolge und Zukunftsaufgaben Europäischer Gesellschaftsrechtsharmonisierung' in S Grundmann (ed), *Systembildung und Systemlücken in Kerngebieten des Europäischen Privatrechts* (Tübingen, Mohr, 2000) 121, 128; S Kalss, Ch Burger, G Eckert *Die Entwicklung des österreichischen Aktienrechts* (Vienna, Linde, 2003) 367.

[61] M Lutter, 'Konzepte, Erfolge und Zukunftsaufgaben Europäischer Gesellschaftsrechtsharmonisierung' in S Grundmann (ed), *Systembildung und Systemlücken in Kerngebieten des europäischen Privatrechts* (Tübingen, Mohr, 2000) 121, 134.

[62] See above Lutter, n 33, at 18.

variety in corporate law. Instead of imposing detailed and onerous rules on economic agents, in many cases minimum requirements may be sufficient to ensure effective protection.[63]

Second, the days of comprehensive harmonisation plans have passed. Legal acts passed at the European level are now subject to the principle of subsidiarity and must be justified on economic grounds. Areas of priority which are deemed to require at least some legal harmonisation must be identified. Various efforts have already been made in this direction. The proposal for the harmonisation of rules governing company groups has been toned down to address only core areas, such as disclosure requirements, minority rights, liability of the group for undue delay in company crises, special investigation, etc.[64] Moreover, in 1996 the EC launched a discussion on the deregulation of European law, including corporate law. The initiative was called 'Simpler Legislation for the Internal Market' (SLIM). A group of corporate law experts came up with a list of proposals to use information technology to reduce disclosure requirements, and to reassess the need for the regulation of company formation, minimum capital requirements and extensive rules on maintaining corporate capital (SLIM Report).[65] Meanwhile, the Commission has already adopted rules, amending the first directive,[66] which requires companies to use the internet.

Further reform efforts were triggered by the surprising and quite dramatic failure of the takeover directive in June 2001.[67] The European Commission established another group of corporate law experts, the so-called high-level group of company law experts,[68] comprising of law professors and experienced practitioners which had the mandate to identify the most important aspects of future takeover regulations for Europe, and to provide the Commission with recommendations for a modern regulatory framework. Two reports summarising the findings of the expert group have

[63] Above Grundmann, n 24, at 561, 575 ff; S Grundmann, 'Wettbewerb der Regelgeber im Europäischen Gesellschaftsrecht — jedes Marktsegment hat seine Struktur' (2001) *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 783, 808.

[64] See KJ Hopt, 'Europäisches Konzernrecht: Zu den Vorschlägen und Thesen des Forum Europaeum Konzernrecht' in H Baums, J Hopt, E Wymeersch (eds), *Corporations, Capital Markets and Business in the Law* (The Hague, Kluwer, 2000) 299 ff, and Ch Windbichler, '"Corporate Group Law for Europe": Comments on the Forum Europaeum`s Principles and Proposals for a European Corporate Group Law' (2000) *European Business Organization Law Review* 265.

[65] 'Results of the fourth phase of SLIM' COM of 4 February 2000 <http://www.europa.eu.int/comm/internal_market/en/update/slim/slim4en.pdf> (2 June 2003).

[66] Directive 2003/58/EC amending Directive 68/151/EC as regards disclosure requirements in respect of certain types of companies [2003] OJ L221/13.

[67] See H Fleischer and S Kalss, *Das neue Wertpapiererwerbs- und Übernahmerecht* (Munich, Beck, 2002) 47, 52.

[68] The group was chaired by Jaap Winter; members were Jan Schans Christensen, José Maria Garrido Garcia, Klaus J Hopt, Jonathan Rickford, Guido Rossi and Joelle Simon.

been delivered, the first (Winter I)[69] focusing on takeover law (including mandatory bids, squeeze-outs and sell-outs), the second (Winter II)[70] proposing a list of priorities for modernising company law and reforming corporate governance systems at the European level. The reports have been widely commented on and on the basis of these comments, the Commission has published its own communication entitled 'Modernising Company Law and Enhancing Corporate Governance in the European Union — A Plan to Move Forward', which outlines the approach the Commission seeks to adopt and the priorities of law reform it has set for itself.[71] Moreover, a new draft directive on a European takeover law was presented by the Commission in October 2002.[72] However, the adoption of this directive has been delayed once more due to disputes among Member States about whether defensive devices that are currently sanctioned by domestic law in various Member States, would be upheld or whether an acquiring company could break through such national defences.[73] Recently, the Commission published a proposal for a Directive on takeover bids which is expected to come into force in the first quarter of 2004.[74] The second Winter Report ranked *Corporate Governance* as the item of *highest priority,* which is not surprising in light of the current crisis of confidence in the capital markets and public companies.[75] Overall it seems to be less important to establish a single model of 'good corporate governance', than to identify the essential elements of a viable model, with the help of economic analysis.[76]

[69] 'Company Law: Commission welcomes experts' report on takeovers' Financial Reporting & Company Law (10 January 2002) *The European Commission* <http://europa.eu.int/comm/internal_market/en/company/company/news/02-24.htm.> (2 June 2003).

[70] 'A modern regulatory framework for company law in Europe' *High Level Group of Company Law Experts* (4 November 2002) <http://www.europa.eu.int/comm/internal_market/en/company/company/modern/consult/report_en.pdf> (2 June 2003). (Winter I)

[71] 'Modernising Company Law and Enhancing Corporate Governance in the European Union — A Plan to Move Forward' COM (2003) 284 final (21 May 2003).

[72] 'Proposal for a Directive of the European Parliament and of the Council on takeover bids' COM (2002) <http://europa.eu.int/eur-lex/en/com/pdf/2002/com2002_0534en01.pdf> (2 June 2003); for a first assessment see HW Neye, 'Der Vorschlag 2002 einer Takeover-Richtlinie' (2002) *Neue Zeitschrift für Gesellschaftsrecht* 1144; A Zinser, 'Ein neuer Anlauf: der jüngste Vorschlag einer Übernahmerichtlinie vom 2.10.2002' (2003) *Europäische Zeitschrift für Wirtschaftsrecht* 10; M Winner, M Gall, 'Der neue Vorschlag einer Übernahmerichtlinie' (2003) *Gesellschafts- und Steuerrecht* 102 ff.

[73] The breakthrough-rule is an invention of the first Winter report (Winter I). It means that domestic rules that offer an effective defense against a takeover, such as restrictions on the transfer of shares, multiple voting rights or voting ceilings would be set aside in the event of a hostile takeover. For details see Winter I above, n 70. However, in December 2003, the European Parliament finally approved a watered down version of the takeover directive. See D Dombay, 'Parliament backs deal on European takeover directive', *The Financial Times (*London, UK, 17 December 2003) 7.

[74] See above n 41.

[75] E Wymeersch, 'Factors and Trends of Change in Company Law' (2000) 4 *International and Comparative Corporate Law Journal* 481-501.

[76] *Ibid*.

Interestingly, and quite consistent with the analysis presented here, the Winter Reports did not recommend immediate legislative activity by the Commission — apart from the takeover directive. Instead, the reports talked about *framework rules on the European level* which should be embedded in the domestic legal systems of the different Member States. The areas singled out for reform in the reports could therefore be addressed by EU legislation, national law, or even be left to private contracting. Finally, the Commission is making efforts to modernise the law drafting procedure. The pace of economic and technological development and change is continuously accelerating. Hence it is important to develop stable and confidence-building regulations, which however should retain sufficient flexibility to accommodate change. In addition, over the last few years the Commission has tried to make its law making process more transparent and more democratic. The Commission has invited all relevant interested persons[77] to contribute to the law making process at an early stage in the form of comments, reports,[78] recommendations, etc.

FINANCIAL MARKET REGULATION

Introduction

EC securities regulation is designed to integrate the domestic securities and investment services markets. A by-product of this integration process has been the advancement of these areas of the law at the Member State level. In some Member States, such as Germany and Austria, securities regulation was very much underdeveloped. But in recent years this system has deepened in scope and regulatory sophistication.[79]

As already mentioned, considerations to promote the integration of the European financial markets through regulation date back to a report by a group of experts headed by Mr Segré,[80] but serious regulatory initiatives were started only 20 years ago with the adoption of the Listing Directive.[81] Other directives followed suit regulating the continuing disclosure of

[77] Mr Bolkestein (member of the Commission) declared that he wanted a full and open debate on the report's recommendations.
[78] For a concerted statement of distinguished German law professors see (2002) *Zeitschrift für Wirtschaftsrecht* 1710 (answering to a questionnaire) and (2003) *Zeitschrift für Wirtschaftsrecht* 863 (statement to the report).
[79] N Moloney, *EC Securities Regulation* (Oxford, OUP, 2002) 5; see also N Moloney, 'The Regulation of Investment Services in the Single Market: The Emergence of a New Regulatory Landscape' (2002) *European Business Organization Law Review* 293, 309, 336.
[80] Europäische Wirtschaftsgemeinschaft, Der Aufbau eines europäischen Kapitalmarkts — Bericht einer von der EWG-Kommission eingesetzten Sachverständigengruppe (Brussel, Segré-report, 1966).
[81] Above, n 37.

financial data, insider dealing and the disclosure of a prospectus before the public offering of a security. Finally, the Investment Services Directive (ISD) regulated the requirements for market participants, regulated markets, and granted — at least to a certain extent — a European passport to investment firms.[82] Despite the fact that financial market regulation is relatively young, the harmonisation accomplished to date is widely regarded to be outdated and inadequate for coping with the emerging pan-European markets.[83]

Scope of Economic Change

Over the last 10-15 years, the financial services industry has undergone a substantial change.[84] Apart from the introduction and increasing acceptance of the Euro, the major trends include:[85] innovation and progress in information and communications technology; institutionalisation and professionalisation of market participants; shifts of economic power among the different market participants; intermediation and simultaneous disintermediation, including broadening of the scope of purveyors of investment-related services;[86] structural change in the landscape of providers of trading facilities (alternative trading systems, international alliances between stock exchanges and/or trading platforms, internal matching of orders by huge market participants); globalisation of the trading in securities and offering-related services as the mobility and internationality of market participants (brokers and other financial services, issuers and major investors) increase

[82] See the enumeration of adopted directives: KJ Hopt and H Baum 'Börsenrechtsreform' in KJ Hopt, B Rudolf and H Baum (eds), *Börsenreform* (Stuttgart, Schaeffer-Poeschel, 1997) 311 ff; S Kalss, 'Kapitalmarktrecht' in M Holoubek and M Potacs (eds), *Österreichisches Wirtschaftsaufsichtsrecht* (Vienna, Springer, 2002) 511 ff: see the comprehensive works of Moloney, above, n 79; S Heinze, *Europäisches Kapitalmarktrecht — Recht des Primärmarkts* (Munich, Beck, 2000); N Elster, *Europäisches Kapitalmarktrecht — Recht des Sekundärmarktes* (Munich, Beck, 2002).

[83] G Ferrarini, 'Securities Regulation and the Rise of Pan-European Markets: An Overview' in G Ferrarini, K Hopt, E Wymeersch (eds), *Capital markets in the age of the Euro* (The Hague, Kluwer, 2002) 241 ff; G Ferrarini, 'The European Regulations of Stock Exchanges: New Perspectives' (1999) *CML Rev* 569, 570; Above Kalss, n 58, at 115.

[84] Above Baum, n 58; S Kalss, 'Different Stock Exchange Interest Groups' in G Ferrarini, J Hopt and E Wymeersch (eds), *Capital Markets in the Age of the Euro* (The Hague, Kluwer, 2002) 193, 204; B Rudolph and H Röhrl, 'Grundfragen der Börsenorganisation aus ökonomischer Sicht' in KJ Hopt, B Rudolph and H Baum (eds), *Börsenreform* (Stuttgart, Schaeffer-Poeschel, 1997) 146 ff.

[85] Above Kalss, n 58; H Baum, 'Technological Innovations as a challenge to exchange regulation: First electronic trading, then alternative trading systems and now "virtual" (internet) exchange?' in T Kono, CG Paulus, H Rajak (eds), *The Legal Issues of E-commerce* (The Hague, Kluwer, 2002) 99 ff.

[86] P Nobel, 'Börsenallianzen und –fusionen' in U Schneider (ed) *Lutter-Festschrift* (Cologne, O Schmidt, 2000) 1485 ff; J Köndgen, 'Mutmaßungen über die Zukunft der europäischen Börsen' in U Schneider (ed), *Lutter-Festschrift* (Cologne, O Schmidt, 2000) 1415.

due to technical support; the increasing importance of equity financing accompanied by the creation of new financial products and investment strategies; and policy and regulatory activities to facilitate cross-border capital flows, market access and innovation in exchange services by deregulation on the one hand, and expanded regulation of affiliated and ancillary services on the other hand.

Need for Reaction by the Regulators

The major function of capital markets and stock exchanges is to channel capital from households to firms. They play a central part in every market economy.[87] A well functioning financial system is crucial for economic growth and development. The process of change and permanent reshaping of global financial markets is accelerating. Analysis and discussion concerning the most appropriate legal framework to meet new demands are not only important for the stock exchange, its members and clients (brokers, issuers and investors) and the capital market itself, but for the whole economy of a state and an economic area.

The new economic landscape has made it necessary to re-think EU policy with regard to the regulation of financial services and capital markets law in general.[88] To analyse regulatory demands under constantly changing technological and economic circumstances, it is helpful to consider the hypothetical case of optimally functioning markets and the interests that may need protection. Moreover, it is useful to identify the different participants present in the market and their respective interests, to keep in mind their traditional positions in light of the current changes when formulating pending regulatory challenges and presenting proposals for adequate regulations.

Regulators today face new challenges arising from the pace of technological development and the integration of financial markets. An increasing number of share issuers do not want to be restricted to a single national market, nor however, do they want to comply with widely divergent regulatory requirements for making a public offer or listing in different countries or at different stock exchanges. In addition, the nature of organised

[87] S Grundmann, 'Ein Binnenmarkt — ganz ohne Schuldvertragsrecht?' (1999) *Europäisches Wirtschafts- und Steuerrecht* H 12 Die erste Seite.

[88] G Ferrarini, 'The European Regulation of Stock Exchanges: New Perspectives' (1999) *CML Rev* 569 ff; the same assessment can be found in various documents of the European Commission; see Commission by presenting the proposal on the New Investment Services directive: Upgrading the investment services Directive 3/22/EEC COM (2000) 729 final (15 November 2000); Proposal for a Directive on Investment Services and Regulated Markets, COM (2002) 625 final; see also the CESR document on Commission Provisional Mandates on the New Investment Services Directive — the Financial Instruments Markets (FIM) Directive, CESR/04-022.

markets has changed, requiring regulators to reconsider the scope of their regulatory powers, in particular to determine the need for regulatory oversight of Alternative Trading Systems (ATS) or Multilateral Trading Facilities (MTF). In light of the integration objectives of the EC, market participants are in principle entitled to operate all over Europe and should increasingly be able to do so provided that they meet the common standard established at the European level. Further, the international integration of financial markets raises important questions about which regulatory authority should govern a particular transaction: the regulator in the home or in the host country? Once this has been determined, ways must be found to ensure the cooperation of regulators of different markets where the shares of the same issuer may be traded and violations of the law may occur. The big question that looms in the background of this debate is whether the current framework with multiple regulators is efficient or whether at least some key competences should be pooled and shifted to a single central authority, such as a European securities and exchange commission.

Still, regardless of the dramatic changes in capital markets, the fundamental issues of financial market regulation are the same as they were 10 or 15 years ago: The *magna charta* of all capital market law is the equal treatment of market participants.[89] A central task for regulatory intervention is to design rules that ensure that this basic principle is being upheld. Examples include rules found in European secondary law mandating equal treatment of all holders of the same class of securities.[90] More generally, regulators need to assure the same conditions for all market participants acting under the same circumstances. Examples include disclosure rules as well as rules that ensure access to special trading facilities or similar entry conditions for market intermediaries, such as investment firms. Finally, the principle of equal treatment guides the interpretation of specific regulations and thereby ensures that markets are sound and fair.

The functioning of markets in accordance with the principle of equal treatment is disturbed by information asymmetry between different market participants as well as conflicts of interest affecting intermediaries as well as issuing firms.[91] In the effort to establish a sound framework

[89] S Weber, *Kapitalmarktrecht* (Vienna, Springer, 1999) 351 ff; H Fleischer, 'Zum Begriff des öffentlichen Angebots im Wertpapiererwerbs- und Übernahmegesetz' (2001) *Zeitschrift für Wirtschaftsrecht* 1563, 1568.

[90] See, for example, Art 3 of the final draft of the Takeover Directive 'Proposal for a Directive on takeover bids' COM (2002) 534 final (2 October 2002); and Scheme C of the Admission to Listing Directive, Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing [1999] OJ L45/5.

[91] See generally J Basedow, 'Economic Regulation in Market Economies' in J Basedow, H Baum, KJ Hopt, H Kanda, T Kono (eds), *Economic Regulation and Competition* (The Hague, Kluwer, 2002) 1 ff.

for markets,[92] regulators seek to mitigate these two problems. Over the past year, the knowledge and awareness of these phenomena have grown in Europe and regulators are now ready to create or improve pertinent regulations.[93] Examples include the new prospectus directive, the new market abuse directive aimed at addressing insider dealing as well as market manipulation,[94] and finally, the proposed new investment services directive.[95] Arguably the importance of these principles has been recognised by the markets and the implementation of the new directives should therefore also be supported by key market participants.

Activities of the European Union

In addition to these more recent activities, the Commission has launched a number of initiatives, which indicate the newly gained importance of financial markets and the extent to which past policies have been reconsidered. In 1999, the Commission launched the ambitious Financial Services Action Plan[96] which stressed the significance of a sound financial market and explained and ranked the core areas of regulation. The Commission has periodically published follow-up reports[97] which describe the process of legal actions and accompanying measures.

Moreover, the Commission established a group of experts charged with writing a report that listed the highest priorities for regulation and development for the deepening and integration of financial services markets in the

[92] See for the European perspective: PO Mülbert, 'Konzeption des europäischen Kapitalmarktrechts für Wertpapierdienstleistungen' (2001) *Wertpapierrechtliche Mitteilungen* 2085, 2094.
[93] Ch Keller and J Langner, 'Überblick über EU-Gesetzgebungsvorhaben im Finanzbereich' (2003) *Zeitschrift für Bank- und Kapitalmarktrecht* 616 ff.
[94] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation [2003] OJ L096/16 (Market Abuse Directive); see also Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation [2003] OJ L339/70; Commission Directive 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest [2003] OJ L339/73; Commission Regulation (EC) 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments [2003] OJ L336/33; CESR04/008b; and the ESC documents found at <http://europa.eu.int/comm/internal_market/en/finances/mobil/market-abuse_en.htm>(10 March 2004).
[95] 'Proposal for a Directive on investment services and regulated markets' COM <http://europa.eu.int/eur-lex/en/com/pdf/2002/com2002_0625en01.pdf> (19 November 2002); cp CESR/04-022, above n 88.
[96] Financial Services: Implementing the framework for financial markets: Action Plan COM (99) 232 (11 May 1999).
[97] 'Financial Services: Action Plan' *Europa* <http://europa.eu.int/comm/internal_market/en/finances/actionplan/> (4 February 2004).

EU and to enhance the competitiveness of Europe vis-à-vis the US and the Far East. The group, the so-called committee of wise men (chaired by Baron Alexandre Lamfalussy)[98] submitted the final report in February 2001 (Lamfalussy Report). The report establishes a list of regulatory priorities. Top on the list is the single prospectus for issuers even when issuing shares in different member systems, which is facilitated by a shelf registration system. In addition, the group listed as important regulatory objectives the modernisation of the listing rules, separate rules for admission and listing, the home country principle determining regulatory oversight for investment firms, the broadening of the scope of investment services covered by the directive and the extension of mutual recognition, the clear distinction between wholesale and retail investors, the modernisation of investment rules for investment funds and pension funds, the adoption of international accounting standards, and finally a single passport for members of recognised stock markets (regulated markets).[99]

New Techniques of Rule Drafting

An important contribution of the report is that it established that the problems facing European financial markets can only in part be attributed to incomplete regulatory coverage at the European level. Of at least equal importance is the process of rule making and rule implementation. To remedy these deficiencies, the Lamfalussy Report proposed a new four-level approach for making and enforcing law at the European level. At the first level, only the core principles of European regulations should be established in the form of framework regulations or directives. At the second level, implementing regulations specifying technical details should be adopted by the Commission. At the third level, representatives of national regulators should coordinate implementation measures. Finally, the fourth level addresses the transparent and effective enforcement of securities regulations.

An important advantage of this multilevel approach, in particular the separate regulation of basic principles and technical details, is that it should facilitate the law making process, as political compromise will have to be found only for the general principles whereas technical details can be made more flexible in response to newly emerging requirements.

Under the existing Treaty, however, this system raises some concerns as to whether or not the European Council is entitled to delegate rule making powers to the Commission under Article 202 of the Treaty.

[98] The Committee of Wise Men, Final Report on the Regulation of European Securities Markets (Brussels, 15 February 2001) — named after the chairman Baron Alexandre Lamfalussy: Lamfalussy-Report 2001; other members were C Herkströter, LA Rojo, B Ryden, L Spaventa, N Walter, N Wicks.
[99] Above n 89.

When confronted with similar issues in the past, the ECJ did not develop clear principles to determine the boundaries between what the Council has to establish and what technical details may be left to the Commission.[100] Absent a clearer mandate in the Treaty, rules promulgated by the Commission on the basis of delegated law making powers may therefore be subjected to long-lasting court procedures, which is likely to weaken confidence in the new regulations but, to an even greater extent, in the European capital market as such.[101]

In response to the recommendations made by the Lamfalussy Report, two committees have been established by decision of the Commission: the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR). The ESC carries out advisory tasks for the Commission and is composed of high-level representatives of the Member States, such as representatives from the ministries of finance. The CESR is an independent advisory body composed of representatives of the regulatory authorities. It advises the Commission on technical rules, facilitates the cooperation between the Commission and the respective national regulatory authorities, and ensures the implementation and enforcement of securities regulation.[102]

Reflecting the Commission's greater commitment to transparency and democratisation of European decision making practices, the process of rule making in the area of financial market regulation is also undergoing change. The public, including interested persons who may or may not be part of established pressure groups, as well as expert committees are invited to participate in the thinking and planning period by submitting ideas, concepts, criticisms and proposals to the Commission either by mail, fax or other media. The public is thus involved at an early stage in the rule making process and interested persons can inform themselves about ongoing projects and their progress.

The Commission initiates the rule making process by transmitting general considerations and various questions to market participants by mail to give them an opportunity to file their opinion.[103] To what extent the Commission's regulatory proposals ultimately reflect these views is,

[100] See only Case 23/75 *Rey Soda v Cassa Conguaglio Zucchero* [1975] ECR 1279; Case 16/88 *Commission of the European Communities v Council of the European Communities* [1989] ECR 3457; Case 291/86 *Central-Import Münster GmbH & Co. KG v Hauptzollamt Münster* [1988] ECR 3679; Case C-240/97 *Kingdom of Spain v Commission of the European Communities* [1999] ECR I 06571; for a short analysis see JP Hix in Schwarze (ed), *Kommentar zum EG-Vertrag* (Nomos, Baden-Baden, 2000) Art 202 EGV Nr 12 ff.

[101] Above Kalss, n 58, at 118.

[102] 'Financial services: Commission creates two new committees on securities' (2001) COM <http://europa.eu.int/ comm/internal_market/en/finances/mobil/01-792.htm.> (2 June 2003).

[103] Consultation Document of the Services of the Internal Market Directorate General; On transparency obligations of issuers whose securities are admitted to trading on a regulated market; consultation on amendments of ISD. COM <http://europa.eu.int/comm/internal_market/en/finances/mobil/transparency/> (26 March 2003).

however, disputed.[104] Moreover, traditional practices of lobbying and channelling of influence still shape policy making in Brussels.[105] Nevertheless, important progress has been made in enhancing transparency and participation.

Examples of the New Legislative Approach

Regulating Issuers: The Directive on the Drafting of a Prospectus

Traditionally, financial market regulations in several continental European systems have focused on the relationship between a share issuing corporation on the one hand, and a (single) stock exchange on the other. In practice, however, double and triple listings at different exchanges, alternative trading platforms, or market operators have become quite common, requiring adjustments in the existing regulatory framework.[106] Existing regulations of multiple listings in more than one country and at markets with different regulatory standards are quite complex and inadequate. Regulations at the EU level have sought to address these problems by introducing partial mutual recognition of the prospectus. This implied that the same prospectus used for public offerings and/or listings in one Member State could also be used in a different one. However, Member States could establish additional requirements or be exempted from mutual recognition in important aspects. As a result, companies did not acquire a single European passport even if they had complied with basic EU law in the first Member State where they issued their shares. Instead, national fragmentation of the primary market remained high.[107] In practice, corporations frequently divide the issuance of shares into a public offering in one Member State and a series of private offerings limited to selected institutional investors in other countries. It is hoped that by granting issuers a European passport, multiple listings at different exchanges can be promoted.[108]

Another important aspect of securities regulation is access to trading facilities, including the migration from one stock exchange or other trading system to another and the partial or complete delisting of companies. Issuers should be allowed to freely choose among different market

[104] See, for example the following critical report: — 'So much for dynamic' *The Economist* (London, UK, 3 November 2001) 68.
[105] See the following example — 'Spoilt choice' *The Economist* (London, UK, 9 November 2002) 81.
[106] Above Ferrarini, n 83; Above Kalss, n 84; Above Kalss, n 58, at 135 ff.
[107] G Ferrarini, 'Pan European Securities Markets: Policy Issues and Regulatory Responses' (2002) *European Business Organization Law Review* 249, 280 ff.
[108] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L 345/64.

operators to reduce their cost of raising equity.[109] The listing process should therefore be standardised and the requirements (in particular the prospectus) for a listing — at least for specific market segments or at qualified trading facilities — harmonised. The new prospectus directive[110] is seen by many as an important legislative step to meet the current requirements of the market.[111] The new directive harmonises the content and the layout of the prospectus, which to this day differs widely from country to country.[112] Greater disclosure requirements provide for equivalent investor protection within the EU. In line with suggestions made in the Lamfalussy Report, the directive is designed as a framework directive. Only core aspects are regulated in the directive, and technical details are left to the Commission and the advising bodies (in particular the CESR).

In addition to disclosure requirements at the time of a corporation's initial public offering, the Commission seeks to establish common standards for continuing disclosure obligations, including ad-hoc disclosure of material facts, and interim reports for major holdings of companies that are listed on a regulated market.[113] The Commission has proposed to increase the frequency of interim reports, to enrich their content, and to shorten the period between the end of the reporting period and the date of disclosure, as well as a mandatory review of the reports. The Commission has already presented detailed working papers for this directive, which can be described as a logical continuation of the European disclosure policy.

Market Participants and Market Abuse

The new directive on market abuse[114] deals with insider dealing and market abuse.[115] It was adopted by the European Council on 3 December 2002. The

[109] B Haar, 'Venture Capital Funding for Biotech Pharmaceutical Companies in an Integrated Financial Services Market: Regulatory Diversity within the EC' (2001) *European Business Organization Law Review* 585 ff.
[110] Above n 39.
[111] Above Ferrarini, n 83 at 290; Ch Crüwell, 'Die Europäische Prospektrichtlinie' (2003) *Die Aktiengesellschaft*, 243.
[112] J Fürhoff and C Ritz, 'Richtlinienentwurf der Kommission über den europäischen Pass für Emittenten' (2001) *Wertpapier Mitteilungen*, 2280–88; B Haar, 'Venture Capital Funding for Biotech Pharmaceutical Companies in an Integrated Financial Services Market: Regulatory Diversity within the EC' (2001) *European Business Organization Law Review* 585, 596 ff; Above Ferrarini, n 83 at 280 ff; T Baums and S Hutter, 'Die Information des Kapitalmarkts beim Börsengang (IPO)' in M Habersack (ed), *Ulmer-Festschrift* (Berlin, de Gruyter, 2003) 779.
[113] European Commission; Internal Market Directorate General: Consultation Document on Transparency Obligations by Issuers whose securities are admitted to trading on a regulated market; for an overview see COM <http://europa.eu.int/comm/internal_market/en/finances/mobil/transparency/> (4 February 2004).
[114] See Market Abuse Directive, above n 94.
[115] See for a first analysis: T Goldmann, 'Marktmanipulation und Insider-Geschäfte: Neue europäische Tatbestände' (2001) *Österreichisches Bankarchiv* 783; M Leppert and F Stürwald,

directive supersedes the 1989 directive on insider trading and amends the basic definition of insider dealing.[116] In addition, it regulates for the first time market manipulation, which is defined as the distortion of the price-setting mechanism, and/or the dissemination of false and misleading information.[117] The directive is an important step in realising the new concept of financial regulation established by the Lamfalussy Report. This is reflected not only in the directive's content, but also in the fact that the new directive requires each Member State to identify a single administrative regulatory and supervisory authority and to vest it with a common set of minimum responsibilities to tackle insider dealing and market manipulation. The directive therefore reflects the third and fourth layers of the regulatory concept for establishing appropriate implementation and enforcement.[118]

Investment Services

The original investment services directive regulates the rights and obligations of investment firms. When enacted in 1993, it formed the backbone of European financial market regulation. The dramatic economic changes have exposed weaknesses and inconsistencies in the directive and it is now in the process of being fundamentally restructured.[119] After an open discussion between the Commission and the market participants, the Commission presented a proposal of a new investment services directive in November 2002.[120] The proposal is again a framework directive, which leaves space for the Commission to stipulate the technical details in a flexible manner.

Marketplace Regulation and Trading Facilities

The investment services directive seeks to establish a threefold approach to the market infrastructure. On the first level, a comprehensive regulatory framework governs the execution of transactions by regulated markets, other trading systems (Multilateral Trading Facilities, 'MTF') and investment firms (internal matching). The core of the regulations deal with the regulated markets, for which the highest requirements must be met

(2002) *Zeitschrift für Bankrecht und Bankwirtschaft* 90 ff; M Gall, 'Die neue Richtlinie über Insidergeschäfte und Marktmanipulation' (2003) *ecolex* 560 ff.

[116] S Fürhoff, 'Neuregelung der Ad-hoc-Publizität auf europäischer Ebene' (2003) *Die Aktiengesellschaft* 80.
[117] See Commission Directive 2003/124/EC, above n 94.
[118] Above Kalss, n 58, at 145.
[119] Above Ferrarini, n 83.
[120] Communications from the Commission to the European Parliament and the Council upgrading the Investment Services Directive 93/22/EEC COM (2000) 729 (15 November 2000).

concerning licensing requirements, supervision, ownership structure, governance and the instruments that will be admitted to trading on the market. On the second level, MTFs are governed by somewhat less stringent rules. MTFs may execute transactions and in this regard are broadly comparable to regulated markets. They are therefore required to comply with most, but not all of the directive's core provisions. Finally, investment service firms are also allowed to execute transactions by way of internal matching. They therefore must comply with the directive's relevant provisions governing disclosure, 'best execution' obligations, conflicts of interest, and general code of conduct. The threefold approach should stimulate competition among the different trading facilities and at the same time offer to the investors a choice between low costs and high risk on the one hand, and greater protection and thus higher costs on the other.

Investment Firms

According to the Proposal of the new ISD[121] the single passport for investment firms shall be strengthened. The single passport entitles investment firms to offer a specified range of investment services in their home state as well as in other Member States.

This includes the extension of the list of core and ancillary investment services that investment firms may offer, the extension of obligations for firms that are offering special services (ie best execution, conflicts of interest), and the concentration of surveillance responsibility in the home country of the investment firm.[122]

The responsibilities for licensing and supervision are vested with the relevant authorities in the country where the investment firm has been established. This home country principle was established already in the previous version of the ISD as well as in the directive on undertakings for collective investment in transferable securities (UCITS),[123] and was recently extended to management companies.[124]

[121] 'Upgrading the ISD' Commission Communication COM (2000) 729 (15 November 2000); Commission communication on the application of conduct of business rules under Article 11 of the investment services directive COM (2000) 722 (14 November 2000); N Hammes, 'Die Vorschläge der Europäischen Kommission zur Überarbeitung der Wertpapierdienstleistungsrichtlinie' (2001) *Zeitschrift für Bankrecht und Bankwirtschaft*, 498 ff; N Moloney, 'The Regulation of Investment Services in the Single Market: The Emergence of a New Regulatory Landscape' (2002) *European Business Organization Law Review* 293 ff.

[122] Above Moloney, n 121.

[123] Directive 2001/107/EC of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses [2002] OJ L041/20.

[124] B Haar, 'Venture Capital Funding for Biotech Pharmaceutical Companies in an Integrated Financial Services Market: Regulatory Diversity within the EC' (2001) *European*

The principle has received some critical review. Opponents point to the lack of competence and expertise of regulators in different countries, the problem of language barriers, the geographic distance between the locality where the violation occurred and that of the regulator, which all make continuous monitoring by the home country regulator quite difficult. Still, in the context of investment services, this approach appears reasonable and consistent with the regulatory regime currently in place. At the same time, the concentration of increasing regulatory responsibilities in the hands of home country authorities creates greater demands on the harmonisation of the rules that govern investment service firms.[125]

Adequate Investor Protection

The reform of investor protection has taken a similar path. It is increasingly recognised that investors are not a homogenous group with identical interests and priorities other than their pursuit of profit in return for capital investments. In order to determine the adequate scope of regulation for their different needs, it is therefore necessary to classify investors and tailor regulations accordingly. The new ISD discussed above, for example, defines different categories of investors depending on the investors' knowledge and experience, their presumed investment objectives, risk profile and financial situation. An important distinction, for example is that between professional and retail investors.[126]

Business Organization Law Review 585, 596 ff; C Callies, 'Heimatstaatprinzip und Europa-Pass (single licence principle) im europäischen Finanzmarktrecht: Wettbewerb der Finanzdienstleister oder der Finanzplätze?' (2000) *Europäisches Wirtschafts- und Steuerrecht* 432 ff; Ch Forstinger, 'Die neue OGAW-Richtlinie für Investmentfonds (UCITS III)' (2002) *Österreichisches Bankarchich* 987 ff; for the Implementation in Germany see 'Vorstellung Entwurf Investment-modernisierungsgesetz' Bundesministerium für Finanzen <http://www.bundesfinanzministerium.de/Anlage20034/Kurzuebersicht-zum-Entwurf-des-Investmentmodernisie-rungsgesetzes.pdf> (27 August 2003); for the Implementation in Austria see 'Regierungsvorlage betreffend das Bundesgesetz, mit dem ein Bundesgesetz über Immobilienfonds (Immobilien-Investmentfondsgesetz — ImmoInvFG) erlassen und mit dem das Bankwesengesetz, das Investmentfondsgesetz 1993, das Kapitalmarktgesetz, das Wertpapieraufsichtsgesetz, das Betriebliche Mitarbeitervorsorgegesetz, das Pensionskassengesetz, das Finanzmarktaufsicht-sbehördengesetz, das Einkommensteuergesetz 1988 und das Körperschaftsteuergesetz 1988 geändert werden' 97 der Beilagen XXII. GP — Regierungsvorlage — Materialien.

[125] See for a comparative analysis, which reveals differences: M Tison, 'Conduct of Business Rules and their implementation in the EU-Member States' in G Ferrarini, KJ Hopt and E Wymeersch (eds), *The Capital Markets in the Age of the Euro* (The Hague, Kluwer, 2002) 65 ff.

[126] For the current ISD: J Welch, 'The sophisticated investor and the ISD' in G Ferrarini, KJ Hopt, E Wymeersch (eds), *The Capital Markets in the Age of the Euro* (The Hague, Kluwer, 2002) 101 ff.

Responsible Authority

The EU is increasingly turning to the institutional structure of financial market regulation. The market abuse directive is the first directive, which explicitly states that Member States must designate a single regulatory and supervisory authority with a common minimum set of responsibilities.[127] Previously, the decision as to how to structure regulatory oversight was left to the individual Member States, provided that some agency had sufficient authority to enforce the directive. The prospectus directive and the new ISD now contain the same requirements. The range of supervisory tasks is expanding and will include the supervision of a greater variety of financial institutions, the expansion of regulatory oversight into new services closely connected with the financial services and capital market (such as trading systems and information services), closer monitoring of disclosure documents, and supervision of specific transactions of listed corporations. Again, the major question regulators in the EU will have to address in the future is whether the current system of multiple regulators in the various Member States can be maintained, or whether the future of European financial markets requires a centralised European authority.[128]

FINAL REMARKS

Corporate law and financial market regulation are moving targets. The scope and accelerating pace of change in the economic and political environments force regulators to react to new developments to ensure effective law enforcement. The EC is responding to these global challenges with a new regulatory approach. The highest level of secondary EU law will comprise increasingly of framework rules, whereas technical details will be left to more flexible law making by the Commission and its advisory bodies. Further, greater emphasis is placed on the implementation and enforcement of EU financial market regulation, including the coordination of actions taken by domestic regulatory agencies.

The coming years will show whether the path the European Union has taken will be successful, in particular whether it will promote the competitiveness of Europe vis-à-vis the US, and whether it will deepen the integration of European capital markets, including those of the new Member States.

[127] Market Abuse Directive, above n 94.
[128] See above Moloney, n 79 at 293 and 336; for the Banking Sector: J Köndgen, 'Regulation of Banking Services in the European Union: a Comparative View' in J Basedow, H Baum, K Hopt, H Kanda, T Kono (eds), *Economic Regulation and Competition* (The Hague, Kluwer, 2002) 27, 51 ff.

References

MA, Bervoets, C, Grechenig, K and Kalss, S (2002) 'The Societas Europea in Relation to the Public Corporation of Five Member States (France, Italy, Netherlands/Spain, Austria)' 3 *European Business Organization Law Review* 733.

Binder, M and Khol, F (2000) 'Bankenehe Hypo Vereinsbank und Bank Austria — Kurzanalyse' *ecolex* 875.

Basedow, J (2002) 'Economic Regulation in Market Economies' in J Basedow, H Baum, KJ Hopt, H Kanda, and T Kono (eds), *Economic Regulation and Competition* (The Hague, Kluwer).

Baum, H (2000) 'Capital Markets and Possible Regulatory Responses' in J Basedow and T Kono (eds), *Legal Aspects of Globalization: Conflict of Laws, Internet, Capital Markets, and Insolvency in a Global Economy* (The Hague, Kluwer).

—— (2002) 'Technological Innovations as a challenge to exchange regulation: First electronic trading, then alternative trading systems and now "virtual" (internet) exchange?' in T Kono, CG Paulus and H Rajak (eds), *The Legal Issues of E-commerce* (The Hague, Kluwer).

Baums, T (1999) 'Corporate contracting around defective regulations: The Daimler-Chrysler case' 115 *Journal of Institutional and Theoretical Economics* (JITE) 119.

Baums, T and Hutter, S (2003) 'Die Information des Kapitalmarkts beim Börsengang (IPO)' in M Habersack (ed), *Ulmer-Festschrift* (Berlin, de Gruyter).

Behrens, P (1996) 'Krisensymptome in der Gesellschaftsrechtsangleichung' in U Immenga, W Möschel and D Reuter (eds), *Festschrift Mestmäcker* (Nomos, Baden-Baden).

Buxbaum, R and Hopt, KJ (1998) *Legal Harmonisation and the Business Enterprise* (Berlin, de Gruyter).

Callies, C (2000) 'Heimatstaatprinzip und Europa-Pass (single licence principle) im europäischen Finanzmarktrecht: Wettbewerb der Finanzdienstleister oder der Finanzplätze?' *Europäisches Wirtschafts- und Steuerrecht* 432.

Crüwell, CH (2003) 'Die Europäische Prospektrichtlinie' *Die Aktiengesellschaft* 243.

Davies, PL (2003) *Gowers Principles of Modern Company Law*, 7edn (London, Thomson/Sweet &Maxwell).

Di Marco, G (1999) 'Der Vorschlag der Kommission für eine 14. Richtlinie' *Zeitschrift für Unternehmens- und Gesellschaftsrecht* (ZGR) 3.

Dombay, D (2003) 'Parliament backs deal on European takeover directive' *The Financial Times (*London, UK, 17 December 2003).

Drygala, T (2001) 'Die Vorschläge der SLIM Arbeitsgruppe zur Vereinfachung des Europäischen Gesellschaftsrechts' *Die Aktiengesellschaft 291*.

Ebke, W (1998) 'Unternehmensrecht und Binnenmarkt: e pluribus unum' *RabelsZ* 197.

—— (1999) 'Unternehmensrechtsangleichung in der Europäischen Union — Brauchen wir ein European Law Institute' in U Hübner and W Ebke (eds), *Großfeld — Festschrift* (Heidelberg, Verlag Recht und Wirtschaft).

Edwards, V (1999) *EC Company Law* (Oxford, Clarendon Press).

Ehrenberg, R (1883) *Die Fondsspekulation und die Gesetzgebung* (Berline, Springer).

Elster, N (2002) *Europäisches Kapitalmarktrecht — Recht des Sekundärmarktes* (Munich, Beck).

Ferrarini, G (1999) 'The European Regulations of Stock Exchanges: New Perspectives' 36 *Common Market Law Review* at 569.

—— (2002) 'Securities regulation and the Rise of Pan-European Markets: An Overview' in G Ferrarini, KJ Hopt, and E Wymeersch (eds), *Capital Markets in the Age of the Euro* (The Hague, Kluwer).

Fleischer, H (2001) 'Zum Begriff des öffentlichen Angebots im Wertpapie-rerwerbs- und Übernahmegesetz' *Zeitschrift für Wirtschaftsrecht* 1563.

Fleischer, H and Kalss, S (2002) *Das neue Wertpapiererwerbs- und Übernahmerecht* (Munich, Beck).

Forstinger, CH (2002) 'Die neue OGAW-Richtlinie für Investmentfonds (UCITS III)' *Österreichisches Bankarchichv* 987.

Fürhoff, J and Ritz C (2001) 'Richtlinienentwurf der Kommission über den europäischen Pass für Emittenten' *Wertpapier Mitteilungen* 2280.

Fürhoff, S (2003) 'Neuregelung der Ad-hoc-Publizität auf europäischer Ebene' *Die Aktiengesellschaft* 80.

Gall, M (2003) 'Die neue Richtlinie über Insidergeschäfte und Marktmanipulation' *ecolex 560*.

Goldmann, T (2001) 'Marktmanipulation und Insider-Geschäfte: Neue europäische Tatbestände' *Österreichisches Bankarchiv* 783.

Grundmann, S (1999) 'Ein Binnenmarkt — ganz ohne Schuldvertragsrecht?' *Europäisches Wirtschafts- und Steuerrecht*.

—— (2001) 'Wettbewerb der Regelgeber im Europäischen Gesellschaftsrecht — jedes Marktsegment hat seine Struktur' *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 783.

—— (2002) 'Regulatory Competition in European Company Law — Some different Genius?' in G Ferrarini, KJ Hopt and E Wymeersch (eds), *Capital Markets in the Age of the Euro* (The Hague, Kluwer).

—— (2002) 'Pan European Securities Markets: Policy Issues and Regulatory Responses' in *European Business Organization Law Review* 249.

Guerrera, F and Jennen, B (2003) 'Germany and UK in joint bid to tougher takeover plans' *The Financial Times* (London, UK, 3 February 2003).

Haar, B (2001) 'Venture Capital Funding for Biotech Pharmaceutical Companies in an Integrated Financial Services Market: Regulatory Diversity within the EC' 1 *European Business Organization Law Review* 585.

Habersack, M (1999) *Europäisches Gesellschaftsrecht* (Munich, Beck).

Hammes, N (2001) 'Die Vorschläge der Europäischen Kommission zur Überarbeitung der Wertpapierdienstleistungsrichtlinie' *Zeitschrift für Bankrecht und Bankwirtschaft* 498.

Heinze, S (2000) *Europäisches Kapitalmarktrecht — Recht des Primärmarkts* (Munich, Beck).

Hommelhoff, P (1992) 'Zivilrecht und der Einfluss europäischer Rechtsangleichung' *Archiv für civilistische Praxis* 71.

—— (2001) 'Einige Bemerkungen zur Organisationsverfassung der Europäischen Aktiengesellschaft' *Die Aktiengesellschaft* 279.

Hopt, KJ (1977) 'Vom Aktien- und Börenrecht zum Kapitalmarktrecht?' *Zeitschrift Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* (ZHR 141) 389.

—— (1992) 'Harmonisierung im europäischen Gesellschaftsrecht' *Zeitschrift für Gesellschaftsrecht* 265.

—— (1998) 'Europäisches Gesellschaftsrecht — Krise und neue Anläufe' *Zeitschrift für Wirtschaftsrecht* (ZIP 19) 96.

—— (2000) 'Kapitalmarktrecht und Aufsicht über Kapitalmarktintermediäre' in S Grundmann (ed), *Systembildung und Systemlücken in Kerngebieten des Europäischen Privatrechts* (Tübingen, Mohr-Siebeck).

—— (2002) 'Europäisches Konzernrecht: Zu den Vorschlägen und Thesen des Forum Europaeum Konzernrecht' in H Baums, KJ Hopt, and E Wymeersch (eds), *Corporations, Capital Markets and Business in the Law* (The Hague, Kluwer).

Hopt, KJ and Baum, H (1997) 'Börsenrechtsreform' in KJ Hopt, B Rudolf and H Baum (eds), *Börsenreform* (Stuttgart, Schaeffer-Poeschel).

Horn, N (2000) 'Internationale Unternehmenszusammenschlüsse' *Zeitschrift für Wirtschaftsrecht* 473.

Kalss, S (2001) *Anlegerinteressen — der Anleger im Handlungsdreieck von Vertrag, Verband und Markt* (Vienna, Springer).

—— (2002) 'New Challenges for Stock Exchanges, investment firms and other market participants' in J Basedow, H Baum, KJ Hopt, H Kanda and T Kono (eds), *Economic Regulation and Competition* (The Hague, Kluwer).

—— (2002) 'Different Stock Exchange Interest Groups' in G Ferrarini, KJ Hopt and E Wymeersch (eds) *Capital Markets in the Age of the Euro* (The Hague, Kluwer).

—— (2002) 'Kapitalmarktrecht' in M Holoubek M Potacs (eds), *Österreichisches Wirtschaftsaufsichtsrecht* (Vienna, Springer).
Kalss, S, Burger, Ch, and Eckert, G (2003) *Die Entwicklung des österreichischen Aktienrechts — Geschichte und Materialien* (Vienna, Linde).
Keller, Ch and Langer, J (2003) 'Überblick über EU-Gesetzgebungsvorhaben im Finanzbereich' *Zeitschrift für Bank- und Kapitalmarktrecht* 616.
Kieninger, EM (1999) 'Niederlassungsfreiheit als Rechtswahlfreiheit' *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 724.
—— (2002) *Wettbewerb der Privatrechtsordnungen im Europäischen Binnenmarkt* (Tübingen, Mohr Siebeck).
Klein, F (1904) *Die neueren Entwicklungen in Verfassung und Recht der Aktiengesellschaft* (Vienna, Manz).
Köndgen, J (2000) 'Mutmaßungen über die Zukunft der europäischen Börsen' in U Schneider (ed), *Lutter-Festschrift* (Cologne, O Schmidt).
—— (2002) 'Regulation of Banking Services in the European Union: A Comparative View' in J Basedow, H Baum, KJ Hopt, H Kanda and T Kono (eds), *Economic Regulation and Competition* (The Hague, Kluwer).
Krause, H (2004) 'BB-Europareport: Die EU-Übernahmerichtlinie — Anpassungsbedarf im Wertpapiererwerbs- und Übernahmegesetz' *Betriebs-Berater* 113.
Lamfalussy, BA (2001), *The Committee of Wise Men, Final Report on the Regulation of European Securities Markets* (Brussels, 15 February).
Leppert, M and Stürwald, F (2002) *Zeitschrift für Bankrecht und Bankwirtschaft* 90.
Lienbacher, G (2000) in Schwarze (ed), *EU-Kommentar* (Nomos, Baden-Baden).
Lutter, M (1996) *Europäisches Unternehmensrecht*, 4th edn (Berlin, de Gruyter).
—— (2000) 'Das europäische Unternehmensrecht im 21. Jahrhundert' *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 1.
—— (2000) 'Erfolge und Zukunftsaufgaben im europäischen Gesellschaftsrecht' in S Grundmann (ed) *Systembildung und Systemlücken des Europäischen Privatrechts* (Tübingen, Mohr Siebeck).
—— (2002) in S Grundmann (ed), *Systembildung und Systemlücken in Kerngebieten des europäischen Privatrechts* (Tübingen, Mohr Siebeck).
Merkt, H (2001) 'Centros and Its Consequences to Member State Legislatures' *International and Comparative Corporate Law Journal* 119.
Moloney, N (2002) *EC Securities Regulation* (Oxford, OUP).
—— (2002) 'The Regulation of Investment Services in the Single Market: The Emergence of a New Regulatory Landscape' 3 *European Business Organization Law Review* 293.
Mülbert, PO (1995) *Aktiengesellschaft, Unternehmensgruppe und Kapitalmarkt* (Munich, Beck).

—— (2001) 'Konzeption des europäischen Kapitalmarktrechts für Wertpapierdienstleistungen' in *Wertpapierrechtliche Mitteilungen.*

Munari, F and Terrile, P (2002) 'The Centros Cases and the Rise of an EC Market for Corporate Law' in G Ferrarini, KJ Hopt, E Wymeersch (eds), *The Capital Markets in the Age of the Euro* (The Hague, Kluwer).

Neye, HW (2002) 'Der Vorschlag 2002 einer Takeover-Richtlinie' *Neue Zeitschrift für Gesellschaftsrecht* 1144.

Nobel, P (2000) 'Börsenallianzen und –fusionen' in U Schneider (ed), *Lutter-Festschrift* (Cologne,O Schmidt).

Priester, HJ (1999) 'EU-Sitzverlegung — Verfahrensablauf', *Zeitschrift für Unternehmens- und Gesellschaftsrecht* (ZGR 6) 36.

Rudolph, B and Röhrl, H (1997) 'Grundfragen der Börsenorganisation aus ökonomischer Sicht' in KJ Hopt, B Rudolph, and H Baum (eds), *Börsenreform* (Stuttgart, Schäffer–Poeschel).

Sanders, C (1960) 'Auf dem Weg zur einer Europäischen Aktiengesellschaft' *Recht der Wirtschaft* 1.

Schmidt, K (1999) 'Sitzungsverlegungsrichtlinie, Freizügigkeit und Gesellschafsrechtspraxis' *Zeitschrift für Unternehmens- und Gesellschaftsrecht* (ZGR 28) 20.

Schön, W (1995) 'Gesellschaftsrecht nach Maastricht', *Zeitschrift für Unternehmens- und Gesellschaftrecht* (ZGR 24) 1.

—— (1996) 'Mindestharmonisierung im europäischen Gesellschaftsrecht' *Zeitschrift für das gesamte Handels- und Wirtschaftsrecht* (ZHR 160) 221.

—— (2000) 'The Concept of the shareholder in European Company Law' 1 *European Business Organization Law Review* 3.

—— (2000) 'Freie Wahl zwischen Zweigniederlassung und Tochtergesellschaft — ein Grundsatz des Europäischen Unternehmensrechts' *Europäisches Wirtschafts- und Steuerrecht* (EWS 11) 281.

—— (2001) 'The Free Choice between the Right to Establish a Branch and to Set up a Subsidiary — a Principal of European Business Law' *European Business Organization Law Review* 339.

Schmidt, K (1999) 'Sitzungsverlegungsrichtlinie, Freizügigkeit und Gesellschafsrechtspraxis' *Zeitschrift für Unternehmens- und Gesellschaftsrecht* (ZGR 28) 20.

Schwarz, G (2000) *Europäisches Gesellschaftsrecht* (Nomos, Baden-Baden).

Teichmann, C (2002) 'Die Einführung der Europäischen Aktiengesellschaft. Grundlagen der Ergänzung durch den deutschen Gesetzgeber' *Zeitschrift für Unternehmens- und Gesellschaftsrecht* (ZGR 31) 383.

Tison, M (2002) 'Conduct of Business Rules and their implementation in the EU-Member States' in G Ferrarini, KJ Hopt and E Wymeersch (eds), *The Capital Markets in the Age of the Euro* (The Hague, Kluwer).

Weber, S (1999) *Kapitalmarktrecht* (Vienna, Springer).
Weber-Ray, D and Schütz, BG (2001) 'Zum Verhältnis von Übernahmerecht und Umwandlungsrecht' *Die Aktiengesellschaft* 325.
Welch, J (2002) 'The sophisticated investor and the ISD' in G Ferrarini, KJ Hopt and E Wymeersch (eds), *The Capital Markets in the Age of the Euro* (The Hague, Kluwer).
Werlauff, E (1993) *European Company Law* (Copenhagen, Jurist- og Økonomforbundets Forlag).
Windbichler, Ch (2000) 'Corporate Group Law for Europe: Comments on the Forum Europeum's Principles and Proposals for a European Corporate Group Law' 1 *European Business Organization Law Review* 265.
Winner, M and Gall, M (2003) 'Der neue Vorschlag einer Übernahmerichtlinie' *Gesellschafts- und Steuerrecht* 102.
Wymeersch, E (2000) 'Factors and Trends of Change in Company Law' 4 *International and Comparative Corporate Law Journal* 481.
Zinser, A (2003) 'Ein neuer Anlauf: der jüngste Vorschlag einer Übernahmerichtlinie vom 2.10.2002' *Europäische Zeitschrift für Wirtschaftsrecht* 10.

12

Complying with EU Corporate Standards: A Practitioner's View from Poland

STANISŁAW SOŁTYSIŃSKI

INTRODUCTION

POLAND'S SYSTEM OF corporate governance has undergone substantial change since 1990, including the privatisation of formerly state-owned enterprises, the establishment of new enforcement agencies, such as the Polish Securities and Exchange Commission, and the reform of the basic legal framework for companies. This chapter will focus on the latter aspect. Its aim is three-fold: (i) to describe the recent codification of Polish company law, focusing on sources of foreign inspiration during the preparatory works of Poland's Codification Commission of Civil Law (Codification Commission); (ii) to sketch the process and consequences of harmonisation of Polish company law with the pertinent EU directives; and (iii) to present the main features of the voluntary set of rules of corporate governance (Rules) adopted by the Warsaw Stock Exchange and approved by the Securities and Exchange Commission.[1]

On 15 September 2000, after three years of preparatory work, the Parliament passed the Code of Commercial Companies (CCC). This comprehensive statute entered into force on 1 January 2001.[2] The CCC consists of 633 articles. The code constitutes a comprehensive regulation of all forms of commercial companies. Apart from modernising the hitherto existing forms of commercial companies and partnerships,[3] the CCC introduced

[1] The Rules were adopted in 2002.
[2] Dz.U. No 94 at 1007 as amended in Dz.U. 2001 No 102 at 1117.
[3] The Commercial Code of 1934, the predecessor of the CCC, covered two types of companies (limited liability companies and joint stock companies, or corporations) and two types of partnerships (the general partnership and the limited partnership). The 'old' forms of commercial entities mirrored the German concepts of *Aktiengesellschaft* (joint stock company [*spólka akcyjna*]), *Gesellschaft mit beschränkter Haftung (*limited liability company *[spólka z*

two new vehicles of doing business; the limited liability partnership and the limited partnership with shares.[4]

The CCC also covers mergers, 'spin-offs' and 'split-ups', as well as rules governing the legal transformation of companies (eg the reorganisation of a partnership into a corporation). Furthermore, the code contains rules on civil and criminal liability, including rules on the liability of members of the board of directors, company promoters and experts verifying the value of in-kind contributions or company assets subject to mergers, among others.

MAIN SOURCES OF FOREIGN INSPIRATION

In search of the most appropriate company law model(s) for Poland, the Codification Commission contemplated three major sources of inspiration: German, French and the Anglo-American law. The long-standing influences of German and French law in Poland are widely known. Both countries are leading EU Member States and the largest investors in Poland. But in the early 1990s, the presence of German and French legal experts in Poland was very limited. The dominance of legal assistance groups and experts financed by the British Know-how Fund and numerous US programmes raised the question of whether Poland may be developing into a common law jurisdiction.

The presence of US and English legal experts in Poland and the leading role of law firms from common law countries notwithstanding, the Anglo-American impact on Polish legislation has been rather limited. The Statute on Registered Pledges and the Register of Pledges of 1996[5] remains the only example of a successful wholesale importation of an Anglo-American legal institution.[6] A combination of cultural and socio-economic factors explains the scarcity of common law transplants in Poland. Foreign drafters, particularly experts from common law countries, are rarely familiar with the legal tradition of the importing country. As rightly observed by Professor Buxbaum, 'efforts conducted in the

ograniczona odpowiedzialnoscia], *offene Handelsgesellschaft* (partnership [*spólka jawna*]), and *Kommanditgesellschaft* (limited partnership [*spólka komandytowa*]).

[4] All legal entities that are regulated in the CCC are grouped into one statutory category of 'commercial companies' (*spólki handlowe*). See Art 2 of the CCC. In the absence of a better legal term in the English language to cover both corporations and partnerships, the two classes of legal entities will be described as 'commercial companies'. English readers of this chapter should be warned that the term 'commercial companies' includes both corporations and partnerships.

[5] As published in *Dziennik Ustaw* [Journal of Laws] (1996), No 149, item 703, as amended.

[6] This law was elaborated by Polish lawyers in close collaboration with US and British experts supported from the Central and Eastern European Legal Initiatives. This initiative was independent of the development of the model law on secured transactions developed by the European Bank for Reconstruction and Development (EBRD).

American missionary tradition which [do] not have regard for cultural peculiarities,' cannot succeed.[7] The resistance to wholesale common law transplants is particularly strong in countries like Poland, Hungary and the Czech Republic, which have preserved their civilian traditions.[8] Therefore, the importation of legislative solutions from neighbouring civilian jurisdictions entails far fewer cultural tensions than in the case of transplanting law patterned on the Anglo-American legal tradition. By contrast, common law missionaries accomplished miracles in the domain of transnational legal practice. Contractual patterns developed by London and New York firms are widely used in Poland. This applies to both traditional trans-border contracts and equity investments. Letters of intent, 'put' and 'call' options, rights of first refusal and shareholders' agreements have become indispensable tools of legal practice in this country.

The choice of the German model for reforming Polish company law is largely attributed to the reputation of the Polish Commercial Code of 1934 (CC), which used the German commercial code as a model. Following its repeal in 1964, the remaining parts of the code regulated the domain of commercial partnerships and corporations (ie limited liability and joint stock companies). The CC represented an almost 'slavish' imitation of the German laws on companies and commercial transactions of the 1930s vintage. It served the needs of the first phase of the Polish economic reforms very well. In fact, its reputation was so good that some conservative scholars and practitioners were of the opinion that the CC needed only cosmetic revisions.

The good reputation of the CC has determined the main direction of the reform of company law. The Codification Commission opted for continuity over change. This meant, inter alia, that the new code retained the basic principles of the CC. The Commission also decided that modern German company law should become the main source of inspiration for the drafters of the bill. The proximity of the two legal traditions, the growing role of German investments in Poland, and the pivotal role of Poland's Western neighbour in the EU were additional factors which justified the choice of this model.

This time around however, the selection of the German model did not result in the slavish imitation of that model. By contrast, the code contains several 'imports' from other legal systems. As a result, the CCC is less Germanic than the code of 1934. For example, the Codification Commission

[7] R Buxbaum, 'Western Support of Law-Reform and Codification Efforts of the Countries of the Former Socialist Bloc as seen from the United States Viewpoint' in Drobnig, Kötz and Mestmäcker (eds), *System Transformation in Mittel-und Osteuropa und ihre Folgen für Banken, B(rsen und Kreditsichrheiten*) (Tübingen, Mohr Siebeck, 1998) at 62–63 (*System Transformation*).

[8] See also S Soltysinski, 'Transfer of Legal Systems as seen by the "Import Countries": A View from Warsaw', in *System Transformation*, *ibid* 70–2.

broke with the tradition of the dualistic structure of private law clearly separating civil law on the one hand and commercial law on the other. Germany remains among only few European jurisdictions where this separation has been preserved. By opting for a monistic concept, according to which company law constitutes part of the general civil law, the CCC follows the Swiss, Italian and Dutch models, which broke with the 19th century tradition of French and German law. This is clearly expressed in Article 2 of the CCC, which states that matters not regulated in the new code shall be governed by the pertinent provisions of the Civil Code. The limited autonomy of company law is reflected in Article 2, Section 2 of the CCC stating: 'Where the nature of the legal relationship of a commercial company so requires, the provisions of the Civil Code shall apply accordingly.'

The CCC differs from the German model in several respects. For example, Judges may depart from the rules of the Civil Code in cases where this is required by overriding concerns of the business transaction in question. Also, German laws on commercial companies and partnerships are regulated by several statutes and the Commercial Code. By contrast, the Polish code is a comprehensive statute embracing not only all forms of commercial companies and partnerships but also mergers, transformations, 'split-offs' and 'split-ups' of commercial entities. In this respect, the draft is closer to the French law on commercial companies and partnerships.

Despite the proximity of the German and Polish legal traditions, the terminology of the CCC is Cartesian rather than Hegelian. Legal commands of the CCC are more general, shorter, and do not attempt to regulate all possible cases to which the law may apply. By implication, they leave more discretion to judges than legislation found in other civil law jurisdictions, such as the very detailed provisions of the German Law on the ransformation of Companies (*Umwandlungsgesetz*). Finally, there are divergences from the German model with respect to specific legal solutions which will be illustrated below.

The first part of the CCC contains provisions common to all or some types of commercial companies (partnerships). The so-called general part of the code covers, among other things, the establishment of companies, rules governing companies in organisation, so-called defective companies, sanctions for violations of the articles of association (the company's statute), company group (*Konzern)* agreements, and the qualification of directors.

The CCC contains the most detailed regulation of the rules governing companies in organisation in Europe. Companies in organisation are companies that are in the process of being incorporated but have not been registered as limited liability or joint stock companies. A major problem that arises during this period is how the law should treat the legal obligations a company in organisation enters into. This is an important practical problem given the length of the incorporation process in Poland which takes 3–4

weeks. It may take several months if the registration court refuses to register the articles of association alleging that its stipulations violate the law and the applicant decides to challenge such a ruling. Again, German law was the main source of inspiration for the authors of the code, who borrowed many concepts developed in recent German case law and legal doctrine, but also departed from the German model in important aspects. The main features of the new regulation of the company in organisation can be summarised as follows.

First, in contrast to the old law (ie CC) and many European company laws, the CCC treats the 'company in organisation' as a legal entity, albeit not as a full-fledged legal person. According to Article 10 of the CCC, a company in organisation may acquire rights and obligations, sue and be sued in its own name.[9] Second, pursuant to Article 11 of the CCC, a company in organisation shall use its business name adding the words 'in organisation'. The code also provides that the company in organisation shall be governed by the pertinent provisions of the law applicable to the mature form of either the limited liability company or the joint stock company, depending on the choice of the company promoters.[10] The code leaves courts and legal commentators with a broad mandate to tailor the new rules regarding companies in their pre-registration phase of incorporation. Third, shareholders of companies in organisation are liable vis-à-vis third parties only up to the value of their respective capital contributions specified in the articles of association (Article 13). This limit on liability incorporates one of the three competing views in the German doctrine.[11] Fourth, the code provides for a simplified procedure for the liquidation of a company in organisation.[12] Fifth, the code adopts the German theory of the identity of a company in organisation[13] and the full incorporated company once registered. At this point the company becomes a legal person and the holder of rights and obligations acquired prior to registration (Article 12). Sixth, joint and several liability of the persons who acted on behalf of the company in organisation

[9] Similar to the dominant view in the German legal literature, a 'company in organisation' is a holder of rights and obligations prior to registration, but it acquires legal personality only upon registration. Cp K Schmidt, *Gesellschaftsrecht* (Berlin, Bonn, München, Carl Heymanns Verlag KG,1994) 848.

[10] The CCC provisions on the 'company in organisation' apply only to limited liability companies (equivalents of German 'Gmbh') and joint stock companies.

[11] The issue of a shareholder's liability before registration divides German commentators. The views range from 'no personal liability vis-à-vis third parties', to unlimited personal liability, to compromise standpoints, according to which shareholders are personally liable up to the value of their unperformed capital contributions. Cp G Sandberger, 'Die Haftung bei der Vorgesellschaft' in B Grosfeld, R Sack, T Möllers, J Drexl and A Heinemann (eds), *Festschrift für W. Fikentscher* (Tübingen, Mohr Siebeck, 1998) 404 ff. (*Festschrift für W. Fikentscher)*. See also G Sandberger, 'Die Haftung bei der Vorgesellschaft-Zur Interaktion von Rechtsdogmatik und Richterrecht' in *Festschrift für W. Fikentscher* at 389 ff.

[12] See Art 161 s 4 and Art 326 CCC.

[13] Cf Schmidt, above n 9, at 857.

ends with the company's registration and the ratification of their acts by the shareholders' meeting. Creditors' consent is not required for transferring these obligations from the persons who acted on behalf of the company in organisation to the fully registered joint stock company.[14]

The general provisions of the CCC contain a few rules on commercial partnerships.[15] They clarify a number of ambiguities of the old CC. The new CCC clearly establishes that commercial partnerships may acquire rights and obligations in their own names, including immovables (real estate). This provision will put an end to the long and unresolved debate about whether partnerships may acquire land and other immovable assets, and whether they have their own right of standing in judicial proceedings. Moreover, pursuant to Article 9 of the CCC, a partnership agreement may change the traditional requirement of unanimity for modifying the partnership agreement. Transferring a stake in a partnership is facilitated by a new provision that allows a partner to assign all of his/her interests and obligations (ie a bundle of rights and duties) in the partnership in a single transaction.

The CC of 1934 provided for only two types of commercial partnerships: the general partnership and the limited partnership (*Kommanditgesellschaft*). They closely resembled the German company forms regulated in the German commercial code in their pre-1930 form. The CCC, however, introduces two new forms of commercial partnerships: the limited liability partnership (an entity similar to US limited liability partnership) and limited partnership with shares (*Kommanditgesellschaft auf Aktien*). In searching for new 'transplants' and solutions in the field of partnership law, the Codification Commission originally planned to follow the French approach which equips all partnerships with legal personality. Ultimately, the followers of the Germanic tradition prevailed and partnerships are classified as legal entities rather than full-fledged legal persons. They enjoy most features of the legal person, but they are classified as 'imperfect' legal persons.[16] The main difference between the fully-fledged legal person and the partnership in the realm of civil law lies in the management structure. Whereas imperfect legal persons are managed by the partners, legal persons are managed by governing bodies. Furthermore, in a typical partnership, the partners assume unlimited liability for the debts of the entity.

Except for the general partnership, the remaining partnerships can be characterised as legal 'hybrids' which contain some characteristics of corporations, which in the civil law tradition are often referred to as capital companies. Opting for the model prevailing in Germany, Austria, Switzerland

[14] On the rights and duties and liability of the company's founders prior to the incorporation of a joint stock company in organisation, cf Art 323 s 4 CCC.
[15] The term 'commercial partnerships' encompasses the general partnership, limited partnership, limited liability partnership, and limited liability partnership with shares.
[16] Art 8 s 1 of the CCC.

and other jurisdictions of the German legal family, the Codification Commission took several factors into account. First, the Germanic legal concepts are well entrenched in the Polish legal tradition. Second, the French concept of legal personality embraces entities representing deeply divergent legal characteristics, but still leaves room for grey areas (eg certain types of consortia). Third, Polish tax laws are based upon the dichotomy of corporate and non-corporate tax treatment. Only partnerships are tax transparent. Hence, granting legal personality to partnerships would expose them to corporate income tax. Alternatively, the reform of company law would have to be coupled with a tax law reform. Given the fact that partnerships are tax transparent, the Codification Commission classified the limited partnership with shares (*Kommanditgesellschaft auf Aktien*) as a commercial partnership. This solution contrasts not only with German law but also with the laws of the Romanist tradition where partnerships are treated as legal persons. Again, an important reason for choosing this solution was the possible tax consequences of the legal classification. The drafters of the CCC were deeply convinced that without tax transparency, this particular business form, which was designed to serve primarily large family businesses that had grown to a size where they needed affordable equity finance, would not be able to attract the attention of economic actors. The fact that tax considerations play an important role in the choice of legal form is widely recognised.[17]

It is worth mentioning that the treatment of a commercial partnership as a legal entity independent of its partners, even though it is not recognised as a legal person, differs from the German model, which does not recognise the concept of legal entity with some, but not all features of full legal personality. By contrast, a new law that will amend the Polish Civil Code clearly recognises the legal capacity of such entities and states that the code's provisions on legal persons shall be applied *mutatis mutandis* to such organisations.

The strong affinity to German law notwithstanding, the limited liability partnership (*spólka partnerska*) is patterned on American prototypes and is designed for organising the business members of free professions, including doctors, lawyer, notaries, and others. The CCC limits the purposes for which an LLP may be organised to the provision of professional services.

The principal reason for including the LLP was the limitation of vicarious liability of partners to third parties, with respect to malpractice claims in the civil law tradition. The new CCC states that a partner is personally liable to third parties only for obligations resulting from his/her own deeds or omissions and for acts of persons under his/her supervision that are

[17] K Schmidt, above n 9, at 16 ff. The author rightly emphasises that the whole development of company and partnership laws is largely dictated by tax considerations.

employed (hired) by the partnership (Article 95). Thus, a partner is not personally liable for acts and omissions of the other partners, nor for persons performing services under their supervision.

In principle, the LLP is managed by all partners collectively and each partner may act on behalf of the entity. The partnership agreement may, however, provide for the establishment of a managing board composed of partners or hired managers. According to Article 97, paragraph 2, the provisions of the code on the management board of a limited liability company (Gmbh) apply *mutatis mutandis* to the board of the LLP. In this case, the non-managing partners enjoy the competencies of the supervisory board. Thus, the optional system of corporate management, which may be attractive to large LLPs, makes this form of partnership a hybrid entity that combines features of the classic partnership and the corporation. Thus, the Polish LLP has characteristics of both the US limited liability partnership and the limited liability company (LLC). Most US partnership statutes provide that an LLC can opt out of the standard management rules in its articles or operating agreements. Thus, even though the management by partners is the rule, the LLC is allowed to have a management structure. The possibility of electing a corporate-like management structure is the most distinctive features of a typical US LLC.[18] It is worth stressing that the US LLP should not be confused with the German or Polish limited liability companies, which are equivalents of a closed corporation under US, or a 'private company' under English law.

In an effort to make all commercial partnerships more attractive to local and foreign business actors, the CCC provides for yet another departure from the German model. Under the Polish CC and its German counterpart, partners were jointly and severally liable with the partnership to third parties. In addition, the partnership's creditors were not required to exhaust their remedies against the partnership before enforcing their claims against the partners. By contrast, the new CCC provides ancillary liability of partners (Article 31). The concept has been borrowed from French and US law. It is similar to the US 'marshalling of assets' approach, which requires that, in the absence of an agreement to the contrary, a creditor shall exhaust its remedies against the partnership before proceeding against its partners.[19] Under the code, the creditor of the LLP may elect to sue both the partnership and its partners, except that obtaining an execution title against the partners is conditioned upon proving that the execution against the partnership has been unsuccessful.

[18] L Ribstein, 'The Emergence of the Limited Liability Company' (1995) 51 *The Business Lawyer* at 1 and 10–11.
[19] R Keatinge, A Donn, G Colemann and E Hesler, 'Limited Liability Partnerships: The Next Step in the Evolution of the Un-incorporated Business Organisation' (1995) 51 *The Business Lawyer* 1, at 151.

The chapter on limited liability companies incorporates most of the traditional legal rules and solutions, apart from a few exceptions, including the recognition of a 'company in organisation' and the legal consequences that follow from this, and of the concept that corporations may be founded by single persons. It was generally agreed that the limited liability company does not require deeper modernisation. By contrast, the law governing joint stock companies has been substantially revised. Apart from harmonising existing rules with EU company law directives, the code introduces a number of innovations when compared with the 1934 CC including:

(i) minimum and/or maximum subscription benchmarks (Article 310 § 10);
(ii) the liberalisation of sanctions for incorporation defects (Article 317);
(iii) advance payment of dividends (Article 349);
(iv) preferred shares (Article 353);
(v) limits on voting privileges and personal privileges for shareholders (Articles 354–56);
(vi) the strengthened role of management and supervisory boards;
(vii) squeeze outs (Articles 416–18);
(viii) rules on the abuse of the right to challenge shareholder-meeting resolutions;
(ix) the concept of authorised unissued stock (Articles 433 ff);
(x) conditional capital increase (Articles 448–54);
(xi) restrictions and acquisition of the company's 'own' shares and redemption of shares (Articles 359–67); and
(xii) comprehensive regulation of mergers, spin-offs, split-offs and transformations of commercial companies (Articles 491–584).

The CCC retained many 'indigenous' approaches developed by the Polish legislative tradition, such as curing incorporation defects and challenges to shareholder resolutions. Still, many of these rules have been changed substantially. Sanctions for incorporation defects have been brought into line with the First EU Company Directive (Articles 11 and 12 of the Directive),[20] while challenges to shareholders' resolutions have been somewhat restricted to the goal of eliminating abuses. For instance, the CCC provides for sanctions amounting to 10 times the value of the litigation costs incurred by a victorious defendant in the case of a manifestly

[20] Council Directive 68/151/EEC of 9 March 1968 on Co-ordination of Safeguards which, for the Protection of the Interests of Members and Others, are Required by Member States of Companies within the Meaning of the Second Paragraph of Art 58 of the Treaty, with a View to Making Such Safeguards Equivalent Throughout the Community (First Company Law Directive) [1968] OJ L 65/8.

groundless challenge. Such special damages may be imposed by the court at the request of the defendant. The Codification Commission also considered the introduction of the German rules on challenging shareholders' resolutions but found them rather complicated.[21]

The CC of 1934 provided that a preferred share may carry up to five votes. The CCC limits the voting privileges to a maximum of two votes per share. Listed companies are required to adopt the one vote per share rule. This solution was favoured by US pension funds and other institutional investors (eg CALPERS). Thus, the new code compromised between the German and Italian laws which, subject to certain exceptions, outlawed all voting privileges on the one hand, and the laws of such jurisdictions as the UK, the Netherlands, and Belgium, where multiple-voting shares are still tolerated. Pre-existing voting privileges have been left untouched in accordance with the principle of protection of acquired rights.

Non-voting shares are patterned on the German and the US concepts of preferred shares. The CCC provides for a detailed regulation of personal rights of shareholders, including the right to appoint members of the managing or supervisory board, rights which in other jurisdictions have been stipulated almost exclusively in case law.[22] The CCC also introduces the concept of 'squeeze out', whereby a majority shareholder(s) who own(s) at least 90 per cent of the share capital of the company may compel minority shareholders to sell their shares for cash. Minority shareholders are entitled to obtain the fair market value of their shares (Articles 418–19). The provisions of the CCC are patterned on the Dutch Civil Code and on 'squeeze outs' regulated in French and Belgian company laws.[23]

Inspired by modern French and English company laws, the CCC stresses the role of the chief executive (president of the management board),[24] yet strengthens the control function of the supervisory board by equipping it with the competence to appoint and dismiss board members. Under the old CC, these powers belonged to the shareholders and were exercised at shareholders' meetings. The powers of the management board have been considerably strengthened by introducing the concept of authorised unissued shares, which gives the management board the power to determine the timing of share issuance. In contrast to many US jurisdictions, these powers of the board require an express authorisation for the management board in the

[21] Cf ss 241–2 of the German law on joint stock companies (*Aktiengesetz)*.
[22] Cf W Kastner, *Grundriss des (sterreichischen Gesellschaftsrechts* (Wien, Manzsche Verlag, 1979) at 158; K Schmidt, above n 9, at 663.
[23] The mandatory acquisition of minority shares was also approved by the Delaware Supreme Court decision in the landmark case *Weinberger v UOP Inc.*, 457 A.2d, 701 Del. Supr. (1983). The court held that, in principle, if there was a full disclosure of all underlying facts, the minority shareholders may only question the appraisal process. The CCC gives the minority shareholders the right to demand the appointment of an independent appraiser by the court.
[24] It consists of granting the president the deciding vote, if the statutes so provide.

articles of associations and require a mandatory quorum, as well as qualified majority requirements for the pertinent resolutions to be passed by a vote of the shareholders.

IMPORTING FOREIGN LEGAL INSTITUTIONS

Apart from harmonising Polish law with the EU company directives, Poland's Codification Commission had to choose the appropriate model for the new company law. The choice of the contemporary German model was dictated by many reasons: the desire to continue the tradition of the CC; the proximity of the two legal cultures; the impact of the German company laws on pertinent EU directives; and the role of German investors in Poland.

Moreover, the Polish Ministry of Justice invited a group of German experts led by Professor M. Lutter (Bonn University), who prepared a detailed critique of an earlier version of the draft of the new code.[25] A fruitful cooperation between the authors of the draft and their German colleagues was made possible by the proximity of the legal cultures of the two neighbouring countries, the attention paid by the German experts to Polish socio-economic peculiarities, and their first-hand experience with legal change in the former German Democratic Republic. This rather rare case of successful cooperation between Western legal scholars and practitioners in a recipient country illustrates Professor Buxbaum's observation that legal assistance efforts cannot succeed without paying due attention to the legal cultural traditions of the recipient country.[26]

The authors of the draft law, with support from the Codification Commission, rejected the temptation to make a wholesale transplantation of any foreign model. Rather, they tried to modernise the law on the basis of the inherited Polish legal tradition by importing selected concepts and solutions from more than one source. Furthermore, the drafters tried to develop new solutions within the limits dictated by the EU company directives and the common sense guideline to avoid 'reinventing the wheel'.

At a previous conference on harmonisation of Central and Eastern European Company laws with EU law,[27] I expressed the opinion that

[25] The team of experts consisted of both practitioners and scholars, including Professor E Meinke (Hamburg), Professor Baier (Jena), and Dr Pelzer (advocate and notary public from Frankfurt). The Draft of the Polish company law was prepared by Professor A Szajkowski (Institute of Legal Sciences, Polish Academy of Science, Warsaw), Professor Szumanski (Jagiellonian University) and the author of this contribution.

[26] R Buxbaum, above n 7, at 62.

[27] The conference was held at the Max Planck Institute in Hamburg in June 2001. For the proceedings of the conference, see K Hopt, C Jessel-Holst, and K Pistor, *Unternehmensgruppen in Transformationslaendern* (Tübingen, Mohr Siebeck, 2003).

Poland should adopt a 'pick and choose' and 'wait and see' approach. This recommendation concerned the 'importation' of new — and largely tested — capital markets and securities laws and regulations and, more generally, legal innovations that do not form part of the binding EU law.[28] This recommendation was based on the premature adoption of the EU Directive on takeovers in Poland, which to this day has not been adopted by the EU. The Polish legislator introduced a mandatory takeover bid (ie the obligation of the acquirer to extend his bid to all remaining shareholders if his acquisition crossed the legally defined threshold) in the early 1990s. The mandatory takeover bid was inspired by the EC Draft Regulation on Takeover Bids (1989)[29] and as patterned to a large extent on the French and Belgian takeover regulations.

The premature introduction of the mandatory public bid obligation was reflected not only in poor drafting, but resulted in an overzealous implementation of the most rigid version of the takeover bid known in the EU. First, the Polish Securities Law adopted the lowest European threshold, triggering the bid obligation once 33 per cent of the votes were in control of the bidder. Second, the rule applied regardless of whether the shares were acquired at a price above the market price or not.[30] Third, the new obligation applied to every consecutive acquisition of shares above the 33 per cent level (eg an increase from 33 to 34 per cent), regardless of whether there was any change in control over the company. Fourth, the Polish takeover bid rules did not provide for any of the exceptions found in the abortive 13th EC Draft of Company Directive on Takeovers Procedures of 1989 (eg the increase of the votes by an investor in the event of redemption of shares). Strikingly enough, the Draft Takeover Directive was dramatically liberalised in 1996 in response to criticism by some Member States. In particular, the Commission had to abandon the attempt to define the threshold that would trigger the mandatory bid obligation and leave this to the individual Member States.[31] Unlike some of its Western European counter parts, the Polish Securities Commission did not have the power to grant individual exemptions. Furthermore, the public bid requirement for all remaining shares of the company was drafted in such a manner that the literal interpretation implied that it was applicable not only to public companies listed on the

[28] See S Soltysinski, above n 8, at 80–2.
[29] Proposal for a Directive of the European Parliament and the Council on Takeover Bids presented by the Commission COM (1988) 823 final (14 March 1989) (Proposal) 8.
[30] In Belgium, for instance, the full takeover bid was compulsory at that time only if the shares were acquired at a price above the market price. See Bruyneel, 'Les offres publiques d'acquisition'(1990) 109 *Journal des Tribunaux* 141–60, 165–82, at 152.
[31] See Streamlined Proposal for Takeover Bid Directive: Proposal for a 13th Company Law Directive concerning takeover bids COM (95) 655 final (7 February 1996). See also n 32, below. The final directive as approved by Parliament in December 2003 was even further liberalised. For details see Pistor's contribution in this volume.

Warsaw Stock Exchange, but to all commercial companies. In effect, this expanded the application of the mandatory bid rule beyond anything contemplated by the EU directive.

Finally, it is worth mentioning that a careful search for an appropriate legal solution in this area of the law would reveal that even a milder version of the Belgian *offres publiques d'acquisition* (mandatory public offer to acquire minority shares), introduced in 1989, stirred controversies and caused complaints from business leaders who argued that the restrictive effects of the rule made transactions more difficult, especially restructuring and privatisation transactions. The fact that the Belgian State has not been able to privatise its shares in Société Nationale de Crédit has been attributed to the adoption of the takeover regime. Prospective private investors declared that the price for bidding for 100 per cent of the shares of the company was too expensive.[32] The lessons from this experience had not been studied in Poland prior to the adoption of the French/Belgian takeover bid model. In addition, the legislature of the time overlooked the fact that Poland is much more dependent than Belgium, or any other EU country, on the influx of foreign capital and the participation of foreign investors in the process of privatising and restructuring state-owned companies. In response to complaints from foreign and domestic investors, the Polish Securities Law was amended in 1999. The threshold triggering the mandatory takeover bid was increased to controlling at least 50 per cent of votes in the target company. Moreover, a number of exemptions were introduced.[33]

The 'pick and choose' and 'wait and see' strategy also seems to be appropriate and topical on the eve of Poland's accession to the EU. The scope of mandatory EU company law the prospective Member States have to adopt in order to comply with the a*cquis communautaire* is relatively narrow. Several important aspects of company law, securities laws, and corporate governance are left untouched by EU harmonisation requirements. This leaves a long list of important company law matters for members states to decide and thereby subject to the 'pick and choose' strategy, including issues such as the choice between two-tier boards and unitary boards, many aspects of defences against 'hostile' takeovers, basic principles regarding managers' liability to the company and its shareholders, proxy votes, managers' duties vis-à-vis stakeholders (ie constituencies other than shareholders), company in organisation and in liquidation, organisation of the shareholders meetings, shareholders' right to information, 'squeeze-outs' and 'reverse squeeze-outs', etc. And this list is by no means exhaustive. Moreover, new

[32] E Wymeersch 'Comparative Corporate Governance' (paper submitted to the Vitznau Conference August/ September 1993) Part II at 284.

[33] It is also worth mentioning that later versions of the EU 'Takeover Bid Directive' substantially liberalised the common minimum standards allowing the Member States to introduce alternative means of protecting minority shareholders.

proposals aimed at reforming the company laws of EU Members States propose to increase the scope of Member States' legislative competencies. Thus, a recently published expert document provides that Member States will be free to choose between unitary and two-tier management boards and replace the traditional mandatory minimum capital requirements by statutory solvency tests.[34] The document also provides for substantial relaxation of several provisions of the Second Company Directive dealing with mandatory notices, verification of in-kind contributions, buy-backs, etc. The aforementioned postulates seem to be in line with the principle of 'subsidiarity', which may acquire new dimensions with the coming enlargement of the EU.[35]

Several new proposals for EU company law reform bear the stamp of the Anglo-American legal systems They include, inter alia, proposals aimed at allowing Member States to substitute the existing minimum capital requirements by a solvency test, liberalising rules governing buy-outs, and adopting such concepts as piercing the corporate veil to protect the creditors of the company and proxy voting in listed companies.[36] These documents were prepared at a time when stock markets on both sides of the Atlantic were booming and prior to the Enron debacle. It remains to be seen what consequences the scandals surrounding the collapse of Enron and many other US companies, and the severe downturn in market performance will have on the ongoing debate about company law reform in Europe.[37]

During the good 'bullish' years of the 1990s, salient characteristics of the US company law and corporate governance were presented by many scholars and practicing lawyers as the best solutions for promoting shareholder capitalism around the world. Today, it is rather clear that the Enron debacle 'challenges some of the core beliefs and practices that have underpinned the academic analysis of corporate law and governance,'[38] including the efficient

[34] Report of the High Level Group Company Law Experts on Modern Regulatory Framework for Company Law in Europe, Brussels, 4 November 2002, at 81–4, 87 ff <http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/report_en.pdf> (11 February 2003) (*Winter Report*).

[35] The principle of subsidiarity of EU law underscores the proposition that the Member States' legislative powers are limited by Community law only to the extent necessary to fulfil the objectives of the Treaty. According to Art 5 of the Treaty, 'in areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiary, only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community'.

[36] See *Winter Report*, above n 34, at 146–55.

[37] For a first assessment, see KJ Haupt, (2002) 'Modern Company and Capital Market Problems — Improving European Law after Enron', *ECGI Working Paper Series* 1 (5). See also the second report of the 'High Level Group of Company Law Experts' *European Commission* >http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/presscomm-group_en.pdf> (Winter Report II of November 2002) (21 August 2003).

[38] J Gordon, 'What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections' (2002) 69 *University of Chicago Law Review* 1234.

market hypothesis, the role of stock markets as effective agents of corporate governance, the extensive powers of the board of directors, the extensive reliance on stock options for rewarding managers, the poor fit between stock-based employee compensation and retirement planning, the efficiency of 'gate-keepers', etc.[39]

This shaken faith in the quality of existing corporate law, in particular the law of the state of Delaware, is well illustrated by a penetrating study recently published by a Delaware judge who stresses the fact that the post-Enron developments justify a critical assessment of the extensive powers of the unitary management boards, judicially developed doctrines of the board's right to say 'no' to take-over bids, and the business judgement rule, which offers managers extensive immunity from malpractice suits, except in the case of bad faith or conflict of interest.[40] The Vice Chancellor of the Delaware Court of Chancery also emphasises that the popular theory of market efficiency and the competing theory of 'race to the bottom' should be critically re-examined.

The latest developments in the US have already influenced discussions on company law in Europe. Recently, the European Union promulgated the long-awaited regulation on European company law (Societas Europaea, 'SE').[41] The regulation seeks to reduce transaction costs by allowing companies with operations in more than one Member State to incorporate as a European company with several subsidiaries, instead of each entity being governed by a different national law, as has been the case so far. At the same time, the regulation covers only selected aspects of company law, leaving it to the Member State to fill the remaining gaps. The founders of the SE have some room to shop for the law of a Member State that best suits them, even though the regulation does not fully endorse regulatory competition. The extent of employee participation in corporate governance, which has been the subject of much contention and stalemates in the history of European company law, is governed in a separate directive that still needs to be transposed by the Member States.[42] It requires that the employees of the companies participating in the establishment of an SE organise themselves and negotiate with the management of the relevant companies the scope of employee participation in the future SE. The most important lesson for the new Member States seems to be that they may induce prospective founders of SEs to incorporate in their country, if they adopt company law provisions that attract rather than deter companies seeking a locus for incorporation.

[39] *Ibid* 1237.
[40] LE Strine, 'Derivative Impact: Some Early Reflections on the Corporation Law Implications of the Enron Debacle' (2002) 57 *Business Lawyer* 1371 ff.
[41] Council Regulation (EC) 2157/2001 of 8 October 2001 on the Statute for a European company (SE) [2001] OJ L294/01.
[42] See Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regards to the involvement of employees [2001] OJ L294/22.

In the good old 'bubble' years, such a model of *Societas Europea* had many supporters who pointed to the success of the US concept of freedom of the place of incorporation of corporations. Now, the Financial Times characterises the European Company statute concept 'to be an explosive demonstration of the law of unintended consequences.'[43] The author gives the opinion that the new EU law triggers the risk of a US-style jurisdictional competition in Europe and stresses the fears of 'a race to the bottom'. Characteristically, this criticism comes not from Bonn or Paris but from London, and refers to critical studies published by English scholars.

Recent trends in stock market development in the US and in the 'old' EU countries present yet another argument in favour of the proposed 'wait and see strategy' for 'new' European countries like Poland. With several of the foundations of the modern US corporation laws requiring critical re-examination, there is little doubt that the ongoing discussion will trigger new ideas and reforms. Far reaching change may, however, require years of preparation and political lobbying, and the new Member States may be ill advised to jump ahead and adopt solutions that have not found backing in the other Member States.[44]

A FOOTNOTE ON CORPORATE GOVERNANCE RULES

In 2002, the Warsaw Stock Exchange (WSE) adopted Corporate Governance Rules for public companies that trade securities on the WSE. The Rules have been approved by the Securities and Exchange Commission (SEC). These Rules, or codes of conducts as they are frequently referred to, are not binding law, but are so called 'soft law', which companies are urged to adopt and adhere to.

The preparatory work was influenced by parallel developments in the US, Canada and EU countries. However, in contrast to the reform of the Polish company law, the authors of the Corporate Governance Rules did not have any leading source of inspiration during their preparatory works.[45]

The Corporate Governance Rules consist of four parts: (i) general principles; (ii) practices recommended to the shareholders' meetings; (iii) corporate

[43] See J Plender, 'Continental capitalism à la carte' *Financial Times* (London, 21 February 2003) 13.

[44] It is worth mentioning that in the aftermath of the 1929 crisis, meaningful legal reforms took place in 1933–1934 culminating in the establishment of the Securities and Exchange Commission.

[45] The Rules have been elaborated by J Socha (Chairman of the SEC), W Rozlucki (President of the Management Board of the WSE), H Bochniarz (President of the Confederation of Private Employers), K Lis (President of Center of Privatization 'Business and Finance') and two law professors: G Domanski and S Soltysinski, Professor Domanski chaired the Committee on Corporate Governance.

governance rules applicable to management boards and supervisory boards; and (iv) rules on external company relations (eg public relations standards). Apart from a few general principles, the Rules consist mainly of specific postulates aimed at curing bad corporate practices identified in the past, in the functioning of Polish public companies. The general principles emphasise, for example, that the main function of the company organs (bodies) is the promotion of the interests of the corporation. Their primary duties are the maximisation of the shareholders' value, even though the interests of other stakeholders, in particular of creditors and employees shall be taken into account. The Rules emphasise the principle of 'majority rule', but state that minority rights shall be protected within the limits established by law. The Rules provide that company organs (bodies) and persons chairing the shareholders' meetings may decide controversies between shareholders or shareholders and the company itself, only within the limits set forth by the applicable laws. All other controversies and disputes belong to the exclusive jurisdiction of the courts.

The Rules on shareholders' meetings are mainly directed at curing problematic practices. According to Rule 6, listed companies shall have by-laws governing the general meeting. Members of the management board and the supervisory board, as well as the company auditors, shall be present at the shareholder meeting. A shareholder who raises an objection to a resolution of the meeting shall be permitted to justify his opposition (Rule 15). The Rules also establish detailed procedures for reconvening a shareholder meeting (Rule 4).

The chapter devoted to supervisory boards sets forth rules concerning the professional and personal qualifications of the board members. Rule 19, for example, provides that at least half of the members of a public company's supervisory board shall be composed of persons who are independent of the company, its shareholders, and employees. The articles of association shall further define the requirements of 'independence' (Rule 20). The board members shall receive a fair but not excessive remuneration. Total remuneration shall be disclosed in the company's annual report.

Among the rules applicable to management boards, the following principles are worth mentioning individually:

Rule 33 provides that the board shall act without transgressing the limits of reasonable business risk, after considering all relevant information, analysis and opinions in a specific situation. Whilst determining the interest of the company, the board members shall give consideration to long-term interests of the company's shareholders and other stakeholders (ie creditors, employees, as well as the local community).

Rule 37 states that managers shall inform the supervisory board of actual and potential conflicts of interest.

Rules 38 and 39 deal with remuneration of managers and stipulates that remuneration shall be reasonably related to the company's size and

economic performance. The amount of the remuneration shall take into account the levels of pay prevailing in similar companies in the relevant market. Finally, the total amount of board remuneration shall be published in the company's annual report, which shall disclose all components of their earnings.

In principle, the Rules are voluntary. However, publicly traded companies are required to declare whether they intend to observe the corporate governance standards. They are free to announce that they do not intend to observe the Rules. Alternatively, they may state that they will comply subject to certain exceptions to be specified in a letter to the WSE. The Rules are subject to the 'comply and explain' principle. A company which has adopted the Rules shall state in its annual report whether it complied with the voluntary code of conduct during the recent accounting year. In an effort to strengthen compliance, the WSE has decided to equip the adjudicating body of the stock exchange with the competence to hear complaints regarding alleged violation of the Rules. If adopted, the new WSE procedural regulations will enable shareholders and investors to file complaints with the court. The decision confirming an alleged act of non-compliance will be published.

It is widely expected that the Rules will be modified and expanded in the future. While local corporate practice will constitute the main source of inspiration, the developments of corporate rules in the EU and in North America will also influence the constant process of fine-tuning Polish corporate governance rules.

CONCLUSIONS

In summary, the process of harmonising Polish company laws and corporate governance rules with the EU legal standards has been accomplished rather successfully. The benefits of the harmonisation and approximation clearly outweigh the costs of such adaptation. But it is equally clear that the harmonisation of laws constitutes only the first and easier task when compared to the second step, namely, the enforcement of the new laws and corporate standards (ie 'soft' laws) in practice.

References

Bruyneel, JG (1990) 'Les offres publiques d'acquisition' 109 *Journal des Tribunaux* 141.

Buxbaum, R (1998) 'Western Support of Law-Reform and Codification Efforts of the Countries of the Former Socialist Bloc as seen from the United States Viewpoint' in U Drobnig, KJ Hopt, H Kötz and

EJ Mestmäcker (eds), *System Transformation in Mittel-und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsichrheiten* (Tübingen, Mohr Siebeck).

Gordon, J (2002) 'What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections' 69 *University of Chicago Law Review* 1230.

Heinemann, A (1998) 'Handelsrecht im System des Privatsrechts — Zur Reform des deutschen Handelsgesetzbuchts' in B Grosfeld, R Sack, T Möllers, J Drexl and A Heinemann (eds), *Festschrift für W. Fikentscher* (Tübingen, Mohr Siebeck).

Hopt, K, Jessel-Holst, C and Pistor, K (2003) *Unternehmensgruppen in Transformationslaendern* (Tübingen, Mohr Siebeck).

Kastner, W, (1979) *Grundriss des (sterreichschen Gesellschaftsrechts* (Wien, Manzsche Verlags).

Keatinge, R, Donn, A, Colemann, G and Hesler, E (1995) 'Limited Liability Partnerships: The Next Step in the Evolution of the Un-incorporated Business Organisation' 51 *The Business Lawyer* 141.

Plender, J (2003) 'Continental capitalism à la carte' *The Financial Times* (London, UK, 21 February 2003).

Ribstein, L (1995) 'The Emergence of the Limited Liability Company' 51 *The Business Lawyer* 1.

Sandberger, G (1998) 'Die Haftung bei der Vorgesellschaft-Zur Interaktion von Rechtsdogmatik und Richterrecht in W Fikentscher' in B Grosfeld, R Sack, T Möllers, J Drexl, A Heinemann (eds), *Festschrift für W Fikentscher* (Tübingen, Mohr Siebeck).

Schmidt, K (1994) *Gesellschaftsrecht* (Berlin, Bonn, München, Carl Heymanns Verlag KG).

Soltysinski, S (1998) 'Transfer of Legal Systems as seen by the "Import Countries": A View from Warsaw' in U Drobnig, KJ Hopt, H Kötz and EJ Mestmäcker (eds), *System Transformation in Mittel-und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsichrheiten* (Tübingen, Mohr Siebeck).

Strine, LE (2002) 'Derivative Impact Some Early Reflections on the Corporation Law Implications of the Enron Debacle' 57 *The Business Lawyer* 1371.

Wymeersch E (1993) 'Comparative Corporate Governance' (Paper submitted to the Vitznau Conference) Part II, 284.

13

Emerging Owners, Eclipsing Markets? Corporate Governance in Central and Eastern Europe[1]

ERIK BERGLÖF AND ANETE PAJUSTE

INTRODUCTION

THE COUNTRIES IN Central and Eastern Europe had different starting points, pursued remarkably different policies, and followed strikingly different trajectories. Despite these differences, the structures of their financial systems are rapidly converging. The contours of post-socialist capitalism are emerging, and the specific challenges of corporate governance are becoming clearer. The purpose of this article is to characterise the main features of the corporate governance challenge facing the countries of Central and Eastern Europe, in particular the countries that have or are bound to join the European Union and to suggest the thrust of policy intervention.

New comparable data on ownership and control, and financing patterns shows that the emerging capitalist systems share many features.[2] While the extent of remaining government ownership differs from one country to another, private ownership dominates everywhere. Ownership and control are becoming increasingly concentrated, with the emergence of corporate groupings and significant foreign owners in most countries. As firms grow

[1] This chapter is a slightly abridged version of a chapter earlier published in P Cornelius and B Kogut (eds), *Corporate Governance and Capital Flows in a Global Economy* (Oxford, Oxford University Press, 2003).

[2] We draw on data collected within the European Corporate Governance Network for all the accession countries in Central and Eastern Europe. This data follows the blueprint set up by a similar data exercise for Western Europe and reported in F Barca and M Becht, *The Control of Corporate Europe* (Oxford, Oxford University Press, 2001). We provide detailed and comparable information on the size of controlling blocks in individual firms in most countries. The data is supplemented with indicators of the legal and general institutional environment, including enforcement variables, and specific information on rules relevant to corporate governance.

in size, ownership and control are separated, primarily using pyramids. Like on the rest of the European continent, firms often have a second large shareholder. Most firms in Central and Eastern Europe are still owner-managed, but professional management is becoming more common. However, even in firms with professional managers controlling shareholders play a critical role. Moreover, for better or for worse, large shareholders are also playing and will most likely continue to play a role beyond their immediate mandate and influence the course of politics, in particular in shaping the rules pertaining to corporate governance and financial sector development.

The emerging ownership and control structures have important implications for corporate governance. In owner-managed firms the fundamental tradeoff is between providing incentives to entrepreneurship and protection of minority investors. The data and rich anecdotal evidence from these countries suggest that strengthening minority protection is of paramount importance in combating fraud and bringing down financing costs. The main concern of this policy priority is that protection of minorities in incumbent firms in takeovers may discourage strategic investors and badly needed restructuring in these countries. The mandatory bid rule requiring owners with large controlling stakes to buy out remaining shareholders also forces firms to de-list, undermining the sustainability of these fledgling stock markets.

As controlling owners gradually distance themselves from day-to-day management in favour of professional managers, the nature of the corporate governance problem changes. Managers must be monitored and only controlling owners have sufficient incentives to perform this task. Even in these firms the main corporate governance conflict remains that between controlling owners and minority investors. But the key tradeoff is one between providing controlling owners with incentives to monitor and protecting minority investors. Once the worst forms of fraud have been contained, excessive emphasis on minority protection would reinforce the informational advantage of management.

The importance of monitoring by the large shareholder is reinforced by the weakness of other mechanisms for corporate governance. With strongly concentrated ownership and control, hostile takeovers and proxy fights are largely ineffective as disciplining devices. Similarly, boards of directors cannot be expected to play an independent role and the role of executive compensation schemes is more limited in companies controlled by a single shareholder. Moreover, litigation is unlikely to be a successful, or reliable, mechanism in environments of weak legal enforcement, and large commercial banks have yet to become deeply involved in financing the corporate sector.

But the current weakness of these supplementary mechanisms does not imply that efforts should not be made to develop them. In the medium term there is some hope that increasing involvement of commercial banks will provide some monitoring. Over time, improved financing opportunities can

increase competition in the market for corporate control and help improve contestability. As the legal environments improve, in particular with respect to enforcement, there is some hope that litigation could also become a mechanism contributing to better corporate governance.

The regulatory response to the emerging ownership and control structures has largely been determined by the process of accession to the European Union. Regulators have emulated existing institutions in current member states and to some extent anticipated possible regulation at the EU level. As a result, the Central and Eastern European countries have adopted regulations that on paper offer stronger minority protection than that of most EU countries. However, in implementation of existing regulation, efforts are made to maintain the incentives for active controlling shareholders. For example, as we document the interpretation of the mandatory bid rule appears to be very lax in several countries, leaving more possibilities for a control premium and facilitating block trades.

We start the next section by describing some current features of the institutional environment of the countries in Central and Eastern Europe. The following section documents the strong concentration of ownership and control in listed firms, but also identifies some differences in patterns across countries. Next we attempt to define main features of the corporate governance problem(s) facing the countries of Central and Eastern Europe, and discuss the implications for the regulatory tradeoffs they are facing; the conclusion follows.

THE INSTITUTIONAL BACKDROP

The Emerging Financial Architecture

Financial sector transition from a planned economy to a market-oriented economy involved transforming a single institution responsible for monetary policy and commercial banking, the so-called monobank, into a decentralised financial system integrated into a market economy. After an initial phase of similar measures to break-up the monobank and dealing with the heritage of central planning, the countries chose very different policies and followed different trajectories of financial development. A 'Great Divide' opened up between those countries that managed to establish a sound institutional foundation, resist pressures to bailout firms, and enforce contracts, and those that did not.[3] Interestingly, the countries that made it to the 'right' side of the divide have managed to combine fiscal and monetary responsibility with the enforcement of contracts.

[3] E Berglöf and P Bolton, 'The Great Divide And Beyond — Financial Architecture in Transition' (2002) 16 *Journal of Economic Perspectives* 77.

The more successful countries in Central and Eastern Europe followed very different financial development policies. This applies to procedures for restructuring bad loans, privatisation strategies for enterprises and banks, policy towards foreign entry in the banking sector, regulatory barriers to entry of new banks, and policies toward stock market development, all of which differed markedly. In particular, countries in transition opted for very different strategies for privatising state-owned enterprises. For example, Hungary started privatisation early and followed a case-by-case sales method, while the Czech Republic opted for a mass voucher privatisation scheme. Poland was slow in implementing mass privatisation, but in the meantime, a large number of individual firms were privatised through management buyouts and liquidation schemes.

Development paths also differed markedly. The standard but very poor measure of credit market development, ie domestic credit to the private sector as a share of GDP, indicates that only in Estonia, Poland, Slovakia and Slovenia did credit expand relatively steadily. The Czech Republic had a very high stock of credit early on, reflecting the mass privatisation of enterprises and extensive bad loans, rather than financial development. After several banking crises during the first half of the 1990s, credit dropped from 45 per cent of GDP in 1990 to 25 per cent in 1994. Since then, its level of credit has expanded in step with economic growth. Similarly, Latvia and Lithuania also recovered after initial banking crises.

In other countries, the link between finance and growth is even weaker. Bulgaria experienced rapid growth in credit in the mid-1990s and then a drastic fall in the late 1990s, but its economy declined or showed moderate growth over this time period. In Russia, financial markets developed rapidly and credit to households and enterprises increased somewhat in the late 1990s, while the economy continued to stagnate. The financial crisis in August 1998 had little long-term impact on real growth; if anything the shock seemed to encourage restructuring and growth. Ukraine, and many other countries that were formerly part of the Soviet Union, did not see any financial development of note.

The financial sectors of these countries have converged. They are now strongly dominated by banks, mainly foreign-controlled, lending primarily to governments and other financial institutions. Banks provide some working capital finance to the corporate sector, but so far have played a limited role in financing investments. Investment finance comes almost exclusively from retained earnings, and most external finance is linked to foreign direct investment. The difference between lending and borrowing rates have declined significantly in level and volatility in most countries of Central and Eastern Europe, but they remain high by the standards of developed market economies. Important weaknesses in the institutional environment, particularly as regards the enforcement of laws and regulation, have yet to be addressed. The process of accession to the European Union is providing useful pressure to bring this process forward.

The Emergence — and Eclipse — of Stock Markets

Countries established stock exchanges at different points of the transition process. Slovenia, Hungary, Bulgaria,[4] Poland and Russia opened their stock markets very early (1990–91), and the Czech Republic, Slovakia and Lithuania followed in 1993. Trading on Latvian and Romanian stock exchanges started in mid-1995, while Estonia did not open up the stock exchange until spring 1996.

The countries followed very different policies towards stock market development in the early stages of transition.[5] This variation can to a large extent be explained by differences in the privatisation policies pursued in the countries. Most of the listed companies are privatised firms, rather than new start-ups. Table 1 shows the development of the number of shares in the stock markets.

Table 1: Number of Listed Securities (All Markets[1])

	1994	1995	1996	1997	1998	1999	2000	2001
Bulgaria	16	26	15	15	998	828	506	392
Czech Republic	1028	1716	1670	320	304	195	151	102
Estonia	0	0	19	31	29	24	21	17
Hungary	40	42	45	49	55	66	60	56
Latvia	0	17	34	51	68	67	63	63
Lithuania	183	351	460	667	1365	1250	1188	902
Poland	44	65	83	143	198	221	225	230
Romania (BSE)	0	9	17	75	126	127	114	65
Romania[a]	0	9	17	5542	6072	5643	5496	5149
Russia	72	170	73	208	237	207	249	243
Slovakia	521	850	970	918	833	830	866	888
Slovenia	.	.	.	85	92	134	154	156
Ukraine	.	.	.	.	125	125	139	128

[1] All equity markets — official and free market.
[a] Bucharest Stock Exchange (BSE) and RASDAQ
Source: Homepages of national stock exchanges; Emerging Markets Database

Among the countries in the region, we can distinguish three approaches.[6] In Bulgaria, Czech and Slovak Republics, Lithuania and Romania listing was mandatory after mass privatisation. The stock exchanges in these countries are characterised by an initial rapid increase in the number of listed companies and then a gradual, in some countries steeper, decrease. In the early phases very few shares were actively traded,

[4] In Bulgaria, during 1992–94 there were about twenty regional stock exchanges, which merged by the end of 1995. The Bulgarian Stock Exchange remained the only operational stock exchange in the country.
[5] S Claessens, S Djankov and D Klingebiel, 'Stock Markets in Transition Economies' *The World Bank* (Financial Sector Discussion Psaper no 5, September 2000).
[6] See above, n 5 for a more detailed discussion of privatisation methods in relation to stock market development in transition economies.

and once the markets became more established illiquid shares have been de-listed as a result of more stringent regulation (eg minimum capital and liquidity requirement).

The other group of countries — Estonia, Hungary, Latvia, Poland,[7] and Slovenia — chose to start with a small number of listed shares, which was increasing as the markets developed. The listed shares were usually voluntary initial public offerings. The third group of countries — Russia and Ukraine — combined both of the previous methods, ie some voluntary offerings and some mandatory listing of minority packages of the privatised enterprises.

The development of market capitalisation also reflects the chosen privatisation method. In countries that followed more gradual privatisation, equity market capitalisation increased slowly (eg Poland, Hungary), while in countries with rapid mass privatisation, market capitalisation jumped to very high levels and then decreased due to de-listing of illiquid shares (eg the Czech Republic).

By the end of 2000, stock market capitalisation was the highest in Russia (see Table 2), followed by Poland, Hungary and the Czech Republic. The rest of the stock markets in the region are negligible, partly due to the small size of the country (Estonia, Latvia, Lithuania, and Slovenia) or poor regulatory framework (Bulgaria, Romania, Slovak Republic, and Ukraine). Nonetheless, even the largest stock exchanges in transition economies are relatively small on a world scale (see comparison with other world markets in Table 2). It is interesting to note that the market capitalisation figures for the front-runners in transition countries are similar to those of Portugal and Greece (the youngest members of the EU) in the mid 1990s.

Table 2: Equity Market (Including Free Markets) Capitalization at the End of Period, in MN USD

	1995	1996	1997	1998	1999	2000	2001
Bulgaria	61	7	2	992	706	617	639
Czech Republic	9,186	14,248	12,786	12,045	12,956	11,391	9,191
Estonia	.	728	1,139	492	1,795	1,733	1,473
Hungary	2,399	5,273	14,975	14,028	16,433	11,926	10,210
Latvia	10	151	337	688	880	590	687
Lithuania	380	1,253	2,173	2,959	3,177	3,052	2,626
Poland	4,564	8,390	12,135	20,461	29,882	31,399	25,933
Romania (BSE)	100	61	632	357	317	366	1,228
Romania[a]	100	61	2,137	1,152	1,313	1,172	2,301
Russia	15,863	37,230	128,207	20,598	72,205	38,922	68,500
Slovakia	5,354	5,770	5,292	4,117	3,568	3,268	3,458
Slovenia	312	891	1,625	2,450	2,880	3,101	3,387
Ukraine	.	.	3,667	570	1,121	1,881	2,850

Table 2 Continues…

[7] Poland had some mandatory listings of mass-privatised companies and National Investment Funds. See above, n 5 and references thereafter.

Table 2 Continued…

Greece	17,060	24,178	34,168	79,992	204,213	110,839	83,481
Portugal	18,362	24,660	38,954	62,954	66,488	60,681	46,337
Spain	197,788	242,779	290,383	402,180	431,668	504,219	468,203
UK	1,407,737	1,740,246	1,996,225	2,374,273	2,933,280	2,576,992	2,164,716
US	6,857,622	8,484,433	11,308,779	13,451,352	16,635,114	15,104,037	13,766,261
Germany	577,365	670,997	825,233	1,093,962	1,432,190	1,270,243	1,071,749

[a] Bucharest Stock Exchange (BSE) and RASDAQ

Source: Homepages of national stock exchanges; Emerging Markets Database; International Federation of Stock Exchanges

The stock markets are also small relative to the size of the economies. In four countries — the Czech Republic, Estonia, Hungary and Lithuania — the market capitalisation to GDP is above 20 per cent. This level compares to Greece and Portugal in the mid 1990s and is slightly below the respective figure in Germany. Bulgaria, Romania and Ukraine, on the other hand, have very low (below 10 per cent) market capitalisation to GDP ratios.

The downward sloping tendency in capitalisation figures after 1999 has several explanations. First, the overall stock market downturn in the world has affected most transition markets adversely. Second, stricter listing requirements (eg the minimum capital requirement, information disclosure and transparency) have forced many companies to de-list. The low number of initial public offerings (IPOs)[8] and the many voluntary de-listings suggest that the costs of listing outweigh the benefits. Listed companies have to provide much more information on a regular basis than unlisted ones, and are subject to more stringent supervision and scrutiny by the public. Third, ownership is becoming increasingly concentrated, and as most of the countries have introduced mandatory bid rules,[9] owners passing a certain threshold must offer to buy the entire firm. As a result they must leave the stock exchange, because one of the listing requirements is that a certain minimum of shares (eg 25 per cent) must be in public circulation. We will return to how the regulatory authorities have tried to mitigate the negative effects of the mandatory bid rule through lax enforcement.

From 'Law-on-the-Books' to Enforcement

Investor protection in corporate law and securities markets regulation differs considerably across countries. Pistor[10] provides a standardised

[8] Most of the countries in the sample still have not had a single IPO. Poland has had in total 47 IPOs by the end of 2000, which is by far the largest number among CEE countries.

[9] An obligation to offer to buy back shares from minority shareholders once a certain threshold is passed. Eg in Hungary this threshold is 33%+1 share (calculated as percent of voting power), in Latvia — 50%.

[10] K Pistor, 'Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies' (2000) 1 *European Business Organisation Law Review* 59.

comparison of 'law-on-the-books' using an aggregated variable, stock market integrity, covering the conflict of interest rules, the independence of shareholder registers, insider trading rules, mandatory disclosure threshold, state control of capital market supervision agency and the independence of capital market supervision (Table 3). For comparison, the cumulative shareholder rights index (called anti-directors index in La Porta et al)[11] is provided for our sample countries, as well as four legal origin groups and world average for 49 countries in the La Porta sample.[12]

These two variables do not provide an idea on how these laws are actually implemented, supervised, and enforced. The European Bank for Reconstruction and Development (EBRD) evaluation of commercial law and financial regulations' extensiveness and effectiveness attempts to

Table 3: Investor Protection

	Stock Market Integrity (Pistor, 2000)				Cumulative shareholder rights (antidirector index in La Porta et al, 1997)			
	1992	1994	1996	1998	1992	1994	1996	1998
Bulgaria	1	1	5	5	4	4	4	4
Czech Republic	3	3	4	5	2	2	3	3
Estonia	0	2	4	4	2	2	3.75	3.75
Hungary	3	3	3	5	2.5	2.5	2.5	3
Latvia	1	1	1	1	3.5	3.5	3.5	3.5
Lithuania	2	1	1	1	2.5	3.75	3.75	3.75
Poland	4	4	4	4	3	3	3	3
Romania	1	1	1	1	3	3	3	3
Russia	2	3	3	3	2	2.5	5.5	5.5
Slovakia	0	2	2	2	2.5	2.5	2.5	2.5
Slovenia	0	3	3	3	0	2.5	2.5	2.5
Ukraine	1	1	1	1	2.5	2.5	2.5	2.5
Average	***1.50***	***2.08***	***2.67***	***2.92***	***2.46***	***2.81***	***3.29***	***3.33***
Common law							**4**	
French civil law							**2.33**	
German civil law							**2.33**	
Scandinavian civil law							**3**	
World Average (49)							**3**	

Source: Pistor (2000); La Porta et al (1997)

capture these aspects. Table 4, for years 1998 and 2000, shows enforcement (effectiveness) is lagging behind the extensiveness. Enforcement of financial regulations was particularly behind, but at the same time it also improved the most in the period from 1998 to 2000.

[11] R La Porta, F Lopez-de Silanes, A Shleifer, and R Vishny 'Legal Determinants of External Finance' (1997) 52(3) *Journal of Finance* (LLSV) 1131.
[12] R La Porta et al, *ibid*.

The court system is still not working efficiently and is characterised by high levels of corruption. The World Bank Business Environment and Enterprise Performance Survey (BEEPS) shows that companies have rather little trust in the judiciary system. We observe that, for example, the Central Bank has considerably higher rating than the courts. The evaluation of fairness, honesty

Table 4: 'Law on Books' vs Enforcement

	Commercial law extensiveness *(law on books)*		Commercial law effectiveness *(enforcement)*		Financial regulations extensiveness *(law on books)*		Financial regulations effectiveness *(enforcement)*	
	1998	2000	1998	2000	1998	2000	1998	2000
Bulgaria	4	4	4	3.7	4	3	3	2.3
Czech Republic	4	3	4	3.3	3.3	4	2.7	2.7
Estonia	3	3.7	4	3.3	3.3	4	2.7	2.7
Hungary	4	4	4	3.7	4	4	4	4
Latvia	3.3	4	2	3.7	3.3	3	2.3	3
Lithuania	4	4	3	3.3	2.7	4	2	3.7
Poland	4	3.7	4	4	4	4	3	4
Romania	4	3.3	4	3.7	3	4	2.7	3
Russia	3.7	3.7	2.3	3	3	3	2	2.7
Slovakia	3	3	2	3	3	3	2	2.7
Slovenia	3	4	3	3.7	3.3	4	2.7	4
Ukraine	2	3.3	2	2	2	3	1.7	2.3
Average	***3.50***	***3.64***	***3.19***	***3.37***	***3.24***	***3.58***	***2.57***	***3.09***

Source: EBRD Transition report (2000). The variable ranges from 1, 1+, 2-… to 4-, 4, 4+. The numbers in this table are constructed as follows: e.g. 3+ is 3.3, 4- is 3.7, and round numbers remain intact.

and enforceability in legal systems is rather poor. The Czech Republic, Latvia, Lithuania (and Russia and Ukraine) have lower than average evaluation in all categories (except the quality of Central Bank for Latvia). This shows that companies in these five countries are more pessimistic (as compared to their counterparts in other sample countries) about the overall efficiency, fairness, honesty and enforceability of the legal system in particular countries.

Kaufmann et al[13] aggregate the governance indicators constructed by different international institutions, databases and consulting firms, and compile country measures for Regulatory Quality, Rule of Law, and Control of Corruption.

The 2000/2001 data show that in all three categories, Romania, Russia, and Ukraine score the lowest, while the Czech Republic, Estonia, Hungary, and Slovenia score the highest. The average regulatory quality, rule of law and control of corruption in transition economies is well below the averages in developed markets. However, there is huge variation within the

[13] D Kaufmann, A Kraay, and P Zoido-Lobaton, 'Governance Matters II: Updated Indicators for 2000/01' *The World Bank* (Policy Research Working Paper, 2002).

Table 5: Aggregate Governance Indicators

	Regulatory Quality		Rule of Law		Control of Corruption	
	2000/2001	1997/1998	2000/2001	1997/1998	2000/2001	1997/1998
Bulgaria	0.16	0.52	0.02	-0.15	-0.16	-0.56
Czech Republic	0.54	0.57	0.64	0.54	0.31	0.38
Estonia	1.09	0.74	0.78	0.51	0.73	0.59
Hungary	0.88	0.85	0.76	0.71	0.65	0.61
Latvia	0.3	0.51	0.36	0.15	-0.03	-0.26
Lithuania	0.3	0.09	0.29	0.18	0.2	0.03
Poland	0.41	0.56	0.55	0.54	0.43	0.49
Romania	-0.28	0.2	-0.02	-0.09	-0.51	-0.46
Russia	-1.4	-0.3	-0.87	-0.72	-1.01	-0.62
Slovakia	0.27	0.28	0.36	0.13	0.23	0.03
Slovenia	0.52	0.53	0.89	0.83	1.09	1.02
Ukraine	-1.05	-0.72	-0.63	-0.71	-0.9	-0.89
Average for TE	***0.15***	***0.32***	***0.26***	***0.16***	***0.09***	***0.03***
Greece	0.71	0.6	0.62	0.5	0.73	0.82
Portugal	0.81	0.89	0.94	1.08	1.21	1.22
Spain	1.08	0.86	1.12	1.03	1.45	1.21
Average	***0.87***	***0.78***	***0.89***	***0.87***	***1.13***	***1.08***
UK	1.32	1.21	1.61	1.69	1.86	1.71
US	1.19	1.14	1.58	1.25	1.45	1.41
Germany	1.08	0.89	1.57	1.48	1.38	1.62
Average	***1.20***	***1.08***	***1.59***	***1.47***	***1.56***	***1.58***

Source: Kaufmann, Kraay, and Zoido-Lobaton (2002); aggregated governance indicators.

sample countries — the best performing transition countries score higher than or close to Greece (eg in 2000/2001 Estonia outperforms Greece in all three categories).

The 10 Central and Eastern European countries can roughly be classified into four groups in terms of their approach to enforcement of investor protection and securities markets regulations. The first group, Poland and Hungary, has chosen strict regulatory mechanisms aimed at investor protection from management and large blockholder fraud. These two countries have also put considerable effort into enforcement mechanisms, often the most deficient part of the legal framework in transition economies. Comparing these two countries, Hungary has weaker regulation than Poland, but its stock market performance is boosted by the specific choice of privatisation method, relying heavily on sales of controlling stakes to foreigners. This method has increased foreign control of local companies and helped generate interest in these stocks, bringing more liquidity to the market.

The three Baltic States and Romania early on implemented rather strict security market regulations. But the capacity of the capital market regulators to fully exercise their regulatory function has been limited, largely due to the lack of clear, legal responsibilities, resources and experience. A weak factor in Estonia and Latvia is disclosure and transparency of information,

eg, on the voting power of controlling owners, concerted action (voting agreements, corporate linkages), as well as sometimes the true identity of the owner (if it is an offshore entity). Lithuania has gone a step further in terms of information disclosure. As mentioned by Olsson, the information on block holdings, structure of the blocks and concerted action is easily available.[14]

The Czech and Slovak Republics did not pay proper attention to the regulatory framework, and has seen fraud, tunnelling of resources and significant stagnation in the local stock markets. The Czech securities law did not require much disclosure (shares could change hands off exchange at less than market price); there was no single clearing and settlement facility; supervision of intermediaries was very lax; and minority shareholders had almost no say against any expropriation and fraud by company managers and Investment Privatisation Funds working in concert with managers. The situation has been improved with the adoption of the once again revised Commercial Code (as of 1 January 2001). The Slovakian case was similar; but more stringent regulations have come in force only as of 1 January 2002. Bulgaria started with a completely unregulated securities market. The situation was slightly improved with the 1995 Law on Securities, Stock Exchanges and Investment Companies, though the law was ambiguous in terms of 'related party' definition, and did not impose any mandatory bid thresholds.[15] The legislation regarding disclosure and definition of related parties improved with the Law on Public Offering and Securities (2000).

Slovenia stands out in this discussion. The Slovenian method of privatisation granted large amounts of shares to employees, former employees and state-controlled public funds. Besides, Slovenian law provides employees with substantial corporate governance rights, including the representation on boards. Privatisation has also proceeded more slowly, leaving substantial ownership stakes in the hands of the government. The large presence of government control (in form of state controlled funds) in the Slovenian privatised corporations is a major obstacle to 'normal' capital market development in Slovenia. Large state interest has also protected the capital markets from foreigners. For example, only in January 1999 were foreign banks allowed to establish branches in Slovenia, and only in July 1999 were branches and subsidiaries of foreign securities firms allowed to enter the market. As a result, even though the level of institutional and technical development of the stock market in Slovenia is quite advanced, the

[14] M Olsson, 'Adopting the Acquis Communautaire in Central and Eastern Europe: a report on the transposition and implementation of the so-called Large Holdings Directive (88/672/EEC)' *European Corporate Governance Network* (Unpublished Manuscript, 2001).
[15] P Tchipev, 'Ownership Structure and Corporate Control in Bulgaria' (Presented at the First Meeting on the South East Europe Corporate Governance Roundtable, Romania, 20–21 September 2001).

local market remains segmented from the world market due to capital market restrictions and a 'semi-socialistic' corporate governance structure (employee and state control).

INCREASINGLY CONCENTRATED OWNERSHIP AND CONTROL

The emergence of stock markets and improvement of disclosure requirements for public companies facilitate the study of ownership and control patterns of companies. The information on identity and stake of owners above a certain threshold should in principle be publicly available. In this section, we present results of a joint effort of a group of researchers carried out under the supervision of European Corporate Governance Network. The data covers companies in 10 Central and Eastern European countries and relate them to comparable information for Western European companies. We also provide some illustrative examples.

Ownership and Control in Listed Companies

After a decade of transition, certain corporate governance patterns have emerged. As can be seen from Table 6, ownership is becoming increasingly concentrated, often exceeding Continental European levels. In all countries but Slovenia with its peculiar half-finished privatisation, the median largest stake was 40 per cent or larger (eg, median voting power of the largest owner in 1999 was 56 per cent in Belgium, 54 per cent in Austria, 52 per cent in Italy but only 39 per cent in Holland and 33 per cent in Sweden).[16] And these numbers are likely to be understated. Reporting standards in transition countries are still lagging behind. Even though formal requirements on disclosure of voting blocks (investors voting in concert) exist, in reality many owners hide behind offshore entities (ie, undisclosed ownership) or act together without disclosing it (based on unofficial agreements).

A detailed analysis of the patterns of ownership concentration for each country allows us to determine the distribution of ownership for each country (See Figure 2).

The first group of countries includes the Czech Republic, Latvia, Poland and Romania, and, in general, resembles the cumulative distributions of Austria, Belgium, Italy, and Sweden. The thresholds of ownership clustering though are different. In the Czech Republic, Latvia and Romania, there is a

[16] See F Barca and M Becht, *The Control of Corporate Europe* (Oxford, Oxford University Press, 2001).

clear clustering around the 50 per cent level, and one half or more of the companies have the largest owner in 49–70 per cent control range. In Poland, there is no clear clustering around any control level, and the concentration

Table 6: Ownership Stakes of Three Largest Shareholders (2000/2001)

	Year	Largest owner		Second largest owner		Third largest owner		Sample size	Comment
		Mean	Median	Mean	Median	Mean	Median		
Bulgaria	2000	59.5	**58.1**	12.7	**10.1**	5.5	**0.0**	104	Direct shareholdings.
Czech Republic	2000	61.1	**52.6**	26.1	**25.3**	13.8	**13.8**	57	Block data.
Estonia	2000	56.2	**54.4**	9.3	**6.7**	4.2	**0.0**	21	Direct shareholdings. Block: 5% of cash flow (=voting) rights.
Hungary	2000	46.2	**43.7**	20.2	**19.5**	10.4	**10.3**	63	Direct ownership. Ultimate ownership and voting rights available only from July 2001. Block: 5% of cash flow rights.
Latvia	2001	57.9	**55.0**	11.1	**7.9**	3.3	**0.0**	60	Direct shareholdings. Block: 5% of cash flow (=voting) rights.
Lithuania	2001	54.2	**49.9**	10.4	**9.9**	5.4	**6.0**	45	Direct shareholdings. Block: 5% of cash flow (=voting) rights.
Poland	2000	44.6	**39.5**	15.6	**10.4**	9.4	**5.0**	210	Voting block data.
Romania	2000	53.4	**53.0**	16.5	**16.0**	9.2	**8.0**	115	Ultimate blockholding (direct and indirect voting stakes have to be disclosed). Information is on voting rights. Compliance though is questionable. Block: more than 5% of votes.
Slovakia	2000	51.6	**45.9**					28	Listed companies (Tier 1 and 2)
Slovenia	2000	27.4	**22.3**	13.4	**12.1**	9.2	**9.5**	136	Based on analysis of ownership stakes (assumed, votes=equity). Generally, firms are not obliged to report voting blocks.
Average		51.2	47.4	15.0	13.1	7.8	5.8		

Source: ACE project "Corporate Governance and Disclosure in the Accession Process" (Contract No. 97-8042-R): Poland (Tamowicz, Dzierzanowski), the Baltic States (Olsson, Pajuste, Alasheyeva), the Czech Republic and Slovakia (Brzica, Olsson, Fidrmucova), Hungary and Romania (Earle, Kaznovsky, Kucsera, Telegdy), Slovenia (Gregoric, Prasnikar, Ribnikar)

level is lower — only in around 35 per cent of firms does the largest owner have more than 50 per cent of votes. The clustering around 50 per cent level can be explained by the mandatory takeover bid threshold, which stands at 50 per cent in Latvia and Romania, and until recently also in the Czech

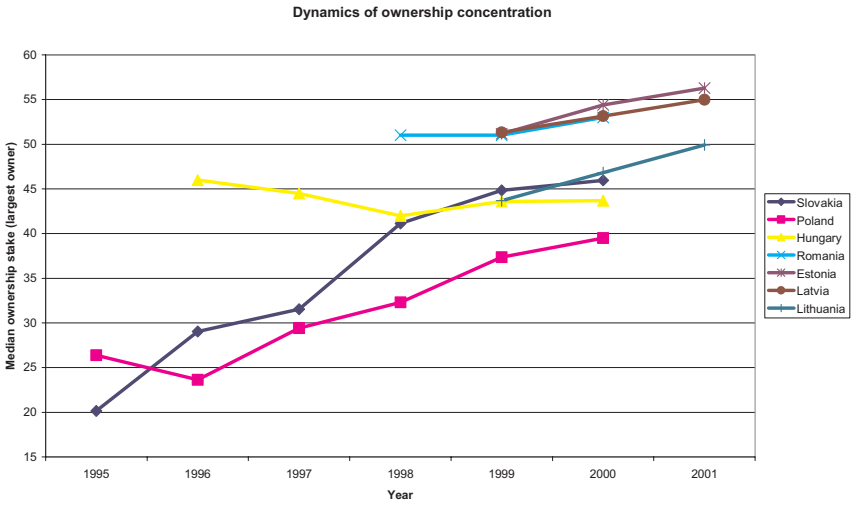
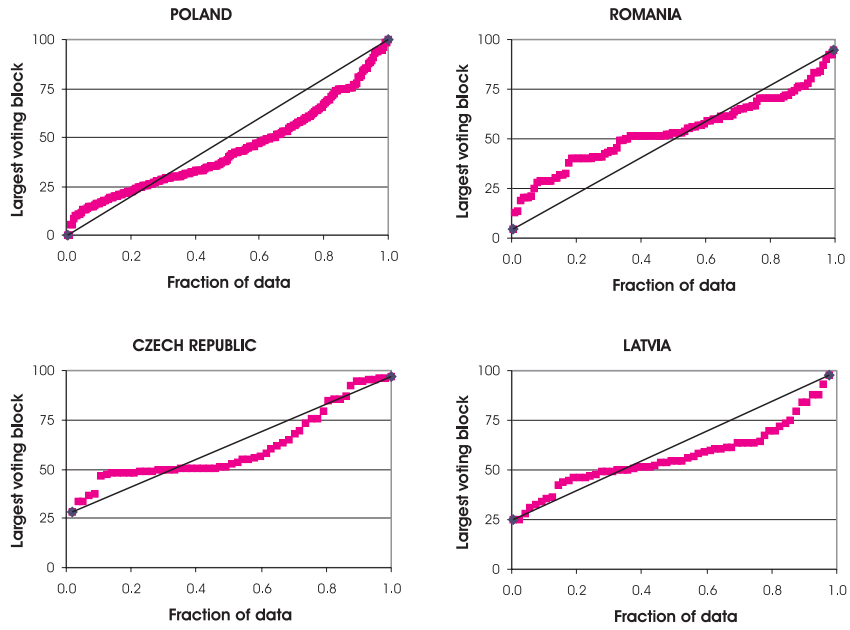


Figure 1: Dynamics of ownership concentration

Group 1: Similar to Austria, Belgium, Italy, and Sweden



Group 2: Similar to the Netherlands and Spain

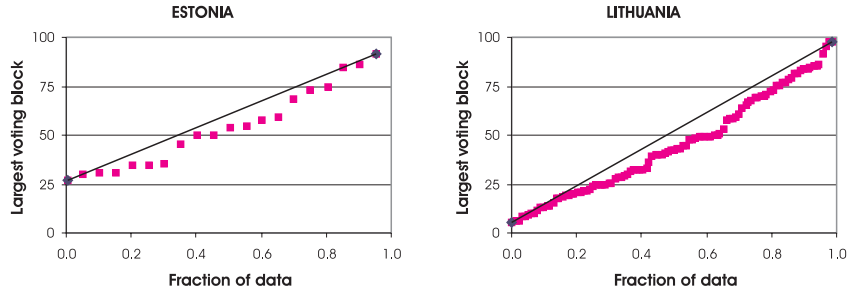
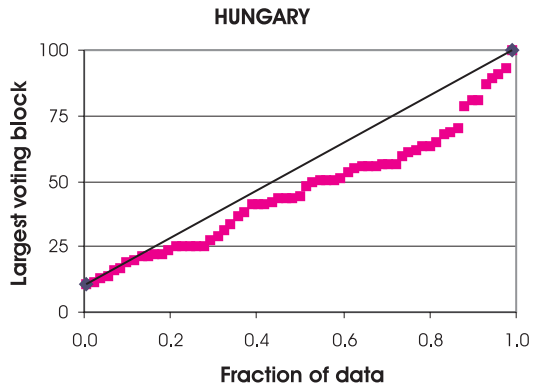
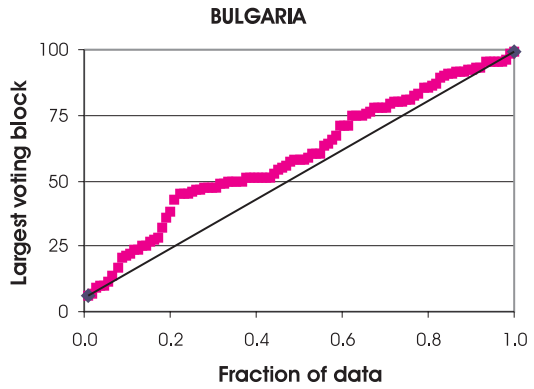


Figure 2: Percentile plots

Group 2 (continued): Similar to the Netherlands and Spain



Group 3: Similar to Germany



Group 4: Similar to U.K.

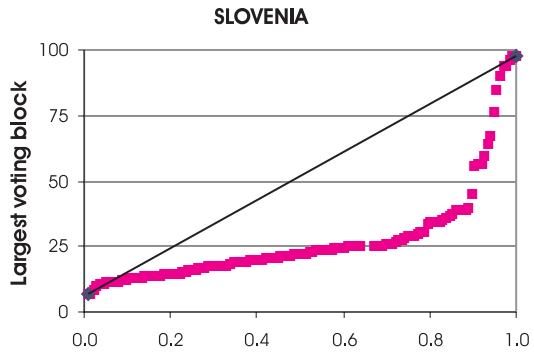


Figure 2: Percentile Plots (continued)

Republic (now the threshold is 2/3 of the voting capital). The mandatory takeover bid threshold in Poland is also 50 per cent but it has been raised from previous 33 per cent. The lower concentration in Poland can thus reflect slow adjustment to the new mandatory bid threshold (ie the owners are not rushing to increase their stakes once the 33 per cent threshold is lifted).

The second group, including Estonia, Hungary and Lithuania, is close to Netherlands and Spain. In Hungary, we observe clustering around the 25 per cent and 50 per cent levels, while in Lithuania, it is around the 50 per cent level. Generally, Estonian and Lithuanian distributions are close to uniform density with a slight bias downwards. The clustering around the 25 per cent level in Hungary can be again explained by the mandatory takeover bid threshold. In Hungary, if there is no other shareholder owning at least 10 per cent of the voting rights, the mandatory bid threshold decreases to 25 per cent (down from standard 33 per cent+1 vote). Until July 2001, Hungarian legislation required that the bidder who intended to acquire 33 per cent + 1 share (calculated as percent of equity) had to make a mandatory bid for 50 per cent + 1 share.[17] This explains the clustering around the 50 per cent level in Hungary. Since July 2001, the threshold remains 33 per cent + 1 share (although it is calculated as a percent of voting power), but the bidder has to make the mandatory bid for all voting shares.

Bulgaria is the only country with distribution above the 45 per cent line (like in Germany), ie private control bias. Again, this may be due to the fact that only direct shareholdings are reported in Bulgaria (as compared to ultimate blocks). Finally, Slovenia stands out with rather dispersed ownership (similar to that of the U.K.), which is a result of the specific privatisation method carried out in Slovenia (where employee ownership funds are controlled by managers).

What explains the observed increase in the concentration of ownership and control in transition economies? In part, the increasing concentration could be fictitious, simply reflecting more stringent supervision of disclosure requirements forcing actual owners to disclose their holdings. Nowadays, the option to hide behind private unlisted companies is limited. In most countries, market regulators can access the information on ownership of unlisted companies and trace any indirect holdings of main shareholders.

There are, however, reasons to believe that ownership is indeed becoming increasingly concentrated. Poor minority shareholder protection, combined with easier access to bank financing, allow the largest shareholders to buy out minorities to avoid the hassle with regulators. Minority shareholders are also, in many cases, eager to sell their shares, recognising that they have

[17] J Earle, V Kaznovsky, C Kucsera, and A Telegdy, 'Corporate Control in Romania' part of the ACE project *Corporate Governance and Disclosure in the Accession Process* (Unpublished Manuscript, Contract no 97-8042-R).

little voice in companies' policies (regarding such things as dividends, calling extraordinary shareholder meetings or appointing independent auditors). Moreover, internal funds and bank loans often suffice to finance companies' growth.

The gradual sellout of state-owned shares is another factor that should have increased ownership concentration. Current majority owners have exploited inside knowledge and contacts to acquire state-owned shares at substantial discounts. While a large fraction of ownership still remains under state control, individuals or families control the largest stake in most of the countries.

Who Controls and How?

Unfortunately, the information on the use of mechanisms for separation of ownership and control, and linkages between owners is still poor. This section provides some scattered information and examples of who controls and how they control corporations in Central and Eastern Europe.

The EU accession countries have followed the EU directives on ownership disclosure. As a result, the requirements for mandatory disclosure of large block holdings have improved substantially during the last couple of years. The definitions of corporate groups and related parties have become more precise. The lowest notification thresholds have decreased. In 1998, according to Pistor et al data, only three sample countries (Bulgaria, the Czech Republic, and Hungary) had the mandatory disclosure threshold at 10 per cent of voting rights.[18] The rest of the countries had either higher thresholds or no block ownership disclosure requirement at all. By 2002, most of the countries had adopted the 5 per cent mandatory block holding disclosure threshold (see Table 7).

Many of the companies currently listed on the stock exchanges in Central and Eastern Europe are a result of privatisation efforts, whether through mass privatisation programs (eg the Czech Republic, Romania, Bulgaria), sales to strategic investors (eg Poland, Hungary, Latvia) or employee and management buyouts (eg Slovenia, Romania). Irrespective of the privatisation method used, the privatisation of former state-owned enterprises gave privileges to managers. As Pistor et al argue,[19] incumbents who held de facto control rights had an advantage over outsiders with weak rights to protect them. Using inside knowledge and political connections, many managers have become major shareholders by employing smart schemes of leveraged buy-outs, buying up employee shares at discounted

[18] K Pistor, M Raiser, and S Gelfer, 'Law and Finance in Transition Economies' (2000) 8 *The Economics of Transition* 325.
[19] *Ibid.*

prices or using other (even purely fraudulent) schemes. As a result, one of the stylised facts in transition countries is strong insider ownership and control. Given weak legislative power to protect outside investors, such companies are highly unattractive to foreign and domestic minority investors.

Poland provides a rich set of illustrative examples. Many enterprises, later listed on the stock exchange, were privatised through management and employee buy-outs. For example, AGROS, a large former state-owned food processing company, was controlled by TIGA — a privatisation vehicle set up by employees and managers of former state-owned enterprise. Through preferred shares (one share — five votes) TIGA controlled 81.4 per cent of Agros Holding's votes, while its share of cash flows was only 47.5 per cent. In fact, full control of AGROS should be assigned to Zofia Gaber (the company's director before privatisation and then the president of management board). She was also the largest owner of TIGA with 18.5 per cent voting stake and chairwoman of TIGA's supervisory board.[20]

At the other end of the spectrum we find a *strong outsider* category, foreign strategic (controlling) investors, with low trust in local management. Sensitised by frequent reports on managerial fraud and entrenchment in emerging markets, foreign strategic owners come with their own management or closely supervise the day-to-day operations of local management. While potentially weakening managerial incentives and entrepreneurial spirit, as well as wasting scarce managerial time on report writing, foreign investors appear to have contributed significantly to corporate restructuring in these countries.[21]

The instruments for separating ownership and control are relatively widely used. *Dual-class shares* (preferred shares) are quite common, but low-voting shares are typically preference shares (see Table 7).

Pyramidal structures are widely used in the sample countries, mainly for two reasons — to limit the equity investment and sometimes to hide the true ownership. In most of the sample countries, the identity of the ultimate owner is still undisclosed due to the laxity in regulation or enforcement of disclosure. *Crossholdings* are also observed. In some countries, companies can also hold their own stock. For example, in Poland, since January 2001, any corporation is allowed to buy up to 10 per cent of its own shares to 'defend against direct, significant damage to a company.'[22] Recently more countries have introduced rules allowing companies, in exceptional cases,

[20] P Tamowicz, and M Dzierzanowski, 'Ownership and Control of Polish Corporations' (2001) *Gdansk Institute for Market Economics* <http://www1.fee.uva.nl/fm/PAPERS/tamowicz1.pdf> (21 January 2004).
[21] S Djankov and P Murrell, 'Enterprise Restructuring in Transition: A Quantitative Survey' (2002) *Center for Economic Policy Research* (Discussion Paper no 3319).
[22] Above n 20.

Table 7: Legal Provisions Governing Selected Investor Protection Issues (2002)

	Mandatory one share – one vote	Mandatory takeover bid (threshold)	Mandatory disclosure of larger blocks (lowest notification threshold)
Bulgaria	**YES** Non-voting preference shares allowed, but they must carry preferential dividend treatment. A preference share shall be entitled to vote when its dividends have been in arrears for one year and are not paid during the following year together with that year's dividends. (Law on Commerce, Art 182)	**50%, 90%** (Law on Public Offering of Securities, Art 149)	**5% (for official market), 10% (for unofficial market)** (Law on Public Offering of Securities, Art 145)
Czech Republic	**NO** Non-voting preference shares allowed up to 50% of the capital. (Commercial Code § 159) Shares with different nominal values (different votes) allowed; limitations can be set in the Articles of Association; voting caps allowed (Commercial Code, 180).	**2/3, 3/4** (Commercial Code § 186)	**5%** (Commercial Code, para 183)
Estonia	**YES** The same as in Bulgaria. (Commercial Code § 237)	**50%** (Securities Market Act, Art 166)	**10%** (Securities Market Act, Art 185)
Hungary	**NO** Preference shares with respect to voting rights allowed. They can carry voting rights that amount to a maximum of ten times the nominal value of the share. May also grant a right of veto. (Act CXLIV of 1997 on Companies, Sec 185; "Business Law in Hungary", p 224)	**33%+1** If there is no shareholder owning at least 10 percent of the voting right, the mandatory bid threshold decreases to 25 %. (Earle et al (2001); Rule in effect from July 2001)	**5%** (BSE Listing Rules, 18.1.1.6)
Latvia	**NO** Issue of ordinary shares with no voting rights or limited voting rights is allowed. Shares without voting rights shall not exceed 40% of the equity capital. (Law on Joint Stock Companies, Art 23.3)	**50%, 75%** (Law on Securities, Art 65)	**5% (main list)** **10% (other public firms)** (Olsson, 2001)
Lithuania	**YES** The by-laws may deprive some of the shares of stock of the right to vote. If all the voting stock is of the same par value, each share of stock shall have one vote at the meetings of the stockholders. (Law on stock corporations, Art 15; from July 1990)	**50%** (Resolution Concerning Rules of Tender Offer)	**10%** (Resolution Concerning Rules on Disclosure)
Poland	**NO** Shares with preferential voting rights are allowed. They must be registered (as opposed to bearer shares). No preference share shall carry more	**50%**	**5%**

Table 7 Continues…

Table 7 Continued…

	than five votes. (Company Law, Art 357; Legal Aspects of Doing Business in Poland)	(Law on Public Trading in Securities, Art 154)	(Olsson, 2001)
Romania	**YES**[1]	50%, 75% (Gov Emergency Ordinance 28, of March 2002)	5% (Olsson, 2001)
Russia	**YES/ NO**[2] (Law on Joint Stock Companies, Art 32)	30% (Law on Joint Stock Companies, Art 80)	20% (Law on Securities, Art 30)
Slovakia	**NO** (Olsson et al., 2001)	…	**5%** (Securities Act; Commercial Code)
Slovenia	**YES** The same as in Bulgaria. (Companies Act)	**25%** If the bidder acquires less than 45% and wants after a year to acquire additional shares, he has to make a bid again. Once 45% threshold is passed, additional shares can be acquired without a bid.	**5%** (Takeover Act, Art 64)
Ukraine	**YES/NO** Non-voting preference shares allowed. (Frishberg et al., 1994)	…	…

[1] Law on Business Companies (Art 67) establishes general one share — one vote rule (except the first general meeting where each shareholder has one vote no matter how many shares held). However, the company's contract or statute can limit the number of votes of shareholders owning more than one share, and thus voting rights can be weighted in specific cases in favor of certain shareholders (i.e. this rule ties voting rights to the specific shareholder rather than to the share).

[2] For common shares there is strict one share — one vote rule. However, Art 32 of Law On Joint Stock Companies provides a broad range of flexibility in structuring the rights of preferred shares, including the ability to establish different types of preferred shares with different rights. This flexibility, according to Black, Kraakman, and Tarassova (1998), can potentially allow companies to evade the one common share, one vote principle. Company's charter can give voting rights to preferred shareholders, including voting rights equal or superior to those of common shares. But at the same time the law does not require that common shares always have lower priority than preferred shares for receipts of dividends. The preferred share holders gain the right to vote if dividends have not been paid only in case if the amount of dividends to be paid is specified in the *company's charter.*

to repurchase their own stock (eg if that is approved by the General Meeting, if it is with the purpose to reduce the share capital, etc) — normally for up to 10 per cent of the company capital. Most often, such an action was prohibited in the original formulations of securities laws in the sample countries.

In addition, many corporate charters contain arrangements specifically designed to defend companies against takeovers. *Voting caps* are used in, among other countries, Slovenia and Poland. In Poland, there are some examples of a provision that is close to the voting cap, but in general such takeover defense is not utilised. *Special shareholder agreements* or *golden shares* are a common way to secure preferential rights when an outside bid

has been launched.[23] In the process of privatisation, strategic investors may have been granted preferential rights in form of shareholder agreement. The following example illustrates the special shareholder rights agreements.

Ventspils Nafta (VN) is the second largest (by market capitalisation) company listed on the Riga Stock Exchange. Its main business activities are transhipment and storage of oil products. The two largest shareholders of VN are *Latvijas Naftas Tranzits* (LNT) (48 per cent) — a company owned by a group of related persons and entities including off-shores — and the State (43.5 per cent). The remaining State shares will be privatised, but the process is very slow due to highly politicised games surrounding the issue. At the first round of privatisation, LNT was granted special preferential rights, namely that it has a veto power over any significant decision (eg strategy, dividend policy or block transfer of shares). Moreover, 5 per cent of the company capital is reserved for LNT. As a result, there is very little chance that (in the remaining privatisation stage) a major shareholder will emerge without an agreement with, or approval of, LNT.

Mandatory Bid Rule and De-Listings

The regulatory frameworks have only in part adjusted to the emerging ownership and control structures, and some of the legislation imposed through the EU accession is directly counterproductive. This is particularly true for the mandatory bid rule requiring an owner who reaches a certain threshold of control to buy out the other shareholders at the same price that he bought his controlling block. This rule makes takeovers prohibitively expensive and effectively closes down the trade in control blocks. Compared to 1998,[24] more countries have introduced the mandatory bid rule (MBR) recently. Meanwhile, one of the few countries that had the MBR before 1997 — Poland — raised the threshold from 33 per cent to 50 per cent, reflecting the pressure of the consolidation trend and need for slowing the withdrawal of companies from the market.[25] Now in most of the sample countries, the mandatory share buy-back threshold is set at 50 per cent of voting rights (see Table 7 above).[26] How can it happen, then, that listed firms continue to be majority and supermajority held (largest owner above 75 per cent of voting power) and there is no share buy-back triggered? We claim that this reflects intentionally weak enforcement.

[23] On the likely impact of recent case law of the European Court of Justice on such practices, see Pistor, chapter 14 in this volume.
[24] Above n 18.
[25] Above n 20.
[26] Moreover, voting rights are explicitly defined (eg, the aggregate voting rights of a person, the company controlled by this person, and a third party, who is committed, on basis of agreement, to carry out joint policies).

We will use Bulgaria, Estonia, Latvia and Romania as illustrative examples. In Bulgaria there are two mandatory bid thresholds — 50 per cent and 90 per cent.[27] The 50 per cent threshold requires everybody, who reaches the level of the voting rights in the general assembly, to offer a bid or to dispose the excessive shares within 14 days of acquisition. The requirement also applies to the holdings of some 'connected persons'.[28] Nevertheless, the largest shareholder in Bulgaria[29] holds on average 59.5 per cent of votes. The most likely reason for this phenomenon in Bulgaria is the loose reference to some 'connected persons'. Even though the suggestions of the EU Large Holdings Directive on accumulation of voting blocks is taken into account in other legislative acts in Bulgaria, the mandatory buy-back rule still refers to 'connected persons' — being entities directly controlled by the shareholder or those voting in concert according to agreement.

The Latvian 'Law on securities' (Article 65) stipulates that a person, who directly or indirectly acquires the stock of a public company in excess of one half or three quarters of the total quantity of votes, shall offer to repurchase the stock belonging to other shareholders. The repurchase offer shall be made also by investors who have voted in favour of the question on withdrawal of stock from public circulation. Accumulation of voting rights is explicitly stated in Article 65, including the voting rights which are acquired by a third person in his or her own name but on assignment of an investor. By law, if the court can prove that two persons were acting in concert without formal agreement, and did not implement the mandatory share buy-back, they would be penalised (including not being able to exercise the voting power above the 50 per cent threshold).

The Latvian problem lays in enforcement and corruption of the court system. There has been a case when the Financial and Capital Markets Commission (FCMC, the main securities market regulator in Latvia) accused a company listed on the main list (the first tier) for violating the mandatory share buy-back rule. The company, confectionary producer *Staburadze*, was 43 per cent owned by the entity controlled by an Icelandic investor. At some point, two other Icelandic investors acquired additional 8.5 per cent and 6.5 per cent of shares. The three Icelandic investors were clearly related (eg being business partners in some entities in Iceland). Moreover, Iceland is not a significant foreign investor particularly favouring Latvia (for reasons of similar size or something else). Nevertheless, when the case was brought to the court, the FCMC was proved to be wrong — the three Icelandic investors were *not* related. The only sanction the FCMC could impose was to remove the company from the main list to the free

[27] The 90% threshold is optional. It provides the right for the shareholder to make a bid, but it is mandatory in a sense that without this bid it is not possible to unregister the company from the register of public companies. See above, n 15.
[28] *Ibid*.
[29] *Ibid*.

(unregulated) market, thus even more dampening the chances of remaining minority shareholders in *Staburadze* to be protected.

In Estonia, the problem seems to be a very loose definition of the mandatory share buy-back rule. By law, the mandatory tender offer has to be made if a dominant position is acquired (being defined as 50 per cent or more of voting rights). But, at the same time, the law provides numerous exceptions to this rule. Securities Market Act (Paragraph 173) stipulates that the authority (Inspectorate) has the right to grant exception (six cases) to the requirement of mandatory tender offer if, for example, 'the company acquired a dominant position over the target issuer from a company belonging to the same group with the latter and after acquiring the dominant position the company continues to belong to the same group' or 'a dominant position was acquired as a result of reducing the share capital of the target issuer.' Also regarding the free float requirement (Listing Rules), the Listing Committee can make exceptions. For example, shares held by a person who has an interest in more than 5 per cent of the shares of the issuer are not regarded as being in public hands *unless* the Listing Committee determines that such a person can for the purposes of this condition be included in the public.

Finally, in Romania (similar to Estonia) there are explicit exceptions to the mandatory tender offer (with the threshold at 50 per cent and 75 per cent of voting power). The Romanian Government Emergency Ordinance 28 (13 March 2002) on 'Securities, Financial Investment Services and Regulated Markets' (Article 135) stipulates that mandatory public offering is not triggered if the control or majority position has been obtained as a results of an *excepted transaction* or *unintentionally*. The excepted transactions include, among others, acquisition of majority position within the privatisation process. Unintentional acquisition is, for example, the result of a decrease in share capital, a conversion of bonds into shares, and a merger or succession.

We suggest that the vagueness of the law (in Bulgaria, Estonia, and Romania) and the poor enforcement of the mandatory share buy-back regulation (in Latvia), at least in part, are deliberate. Given the concentration of ownership, most companies would be forced to de-list under a strict enforcement of the rule. Also, such a rule would essentially close down the market for hostile takeovers and erase any possibility for controlling owners to capitalize the control rent.

DEFINING THE CORPORATE GOVERNANCE PROBLEM

The corporate governance system provides a set of mechanisms designed to control the fundamental agency problem between management and shareholders. These mechanisms include large shareholder monitoring,

markets for takeovers, proxy fights, board intervention, litigation, bank monitoring, and executive compensation schemes.[30] They are supplemented by the checks on behaviour provided by general norms and business ethics, and media. The relative importance of these mechanisms depends on the ownership and control structure in the individual firm, which in turn shapes the agency problem, and the broader environment in which the firm operates. The scope for hostile takeovers and proxy fights, for example, depend on the stake of the controlling owner and the general institutional environment, influencing an outside investor's possibilities to exercise any rights.

The corporate governance problem in Central and Eastern Europe is shaped by increasingly concentrated control structures, typically with the controlling owner actively involved in the management of the firm. Mechanisms for separation of ownership and control are widely used. The financial architecture is still embryonic, but the dominant feature is a strong presence of foreign-controlled banks. These financial institutions are only marginally engaged in financing corporate investment. While the legal and general institutional environment has improved tremendously over the last decade, important issues of enforcement remain. The law makers and regulators will have to design policies with this reality in mind.

Most of the world never went through the dispersion of shareholdings, and as we have suggested, these countries are unlikely to go through it any time soon. Given that a class of professional managers has yet to emerge, and that management in any case cannot be expected to be independent in heavily concentrated ownership structures, the main conflict in these firms will be between controlling shareholders and minority investors. It is in this perspective that we have to revisit some key tradeoffs in the regulation of corporate governance: between managerial initiative and investor protection; between the interests of large blockholders and those of minority investors; and between minority investor protection and the market for corporate control.

Before discussing these tradeoffs, there is also the perennial issue of the appropriate balance between 'shareholder value' and considerations for other stakeholders, which will also remain important given the heritage in the countries. In some Central and Eastern European countries, a heritage of employee ownership and a strong role for unions and local community interests are a feature of corporate decision making. In others, unions are much weaker than in Western Europe. There are no simple recipes for how to strike the right balance, but the particular stakeholder tradition inherited from socialist times and early phases of transition will most likely leave sediments in corporate governance for years to come. Many stakeholders

[30] Becht et al, 'Report to the Commission from ECGN/EAST BEEPS study, 1999' (2002) *The World Bank* <http://info.worldbank.org/governance.beeps/> (March 2003).

matter to the success of a corporation, and much of the managerial challenge lies in balancing off these different interests. But there are important advantages to relatively simple measures of corporate performance, and shareholders are more likely to agree on such objectives. Shareholders are also the only stakeholder group that does not have a collective exit option (as long as the firm is a going concern); any shareholder that wants to leave the firm has to find a buyer of his share.

The classic corporate governance conflict is that between management and shareholders. Early contributors to the corporate governance literature in the United States worried about the increasing dispersion of shareholdings and the increasing discretion of managers.[31] Much of the regulatory response in this country has been about trying to trade off the benefits of increased discretion for managerial incentives against the protection of shareholders. With too much protection, managers would have little incentives and room to use their initiative to improve the performance of the firm; with too little protection, investors would not contribute sufficient funds or demand very high interest.[32] As we have argued, this is unlikely to be the key tradeoff in Central and Eastern European economies in the foreseeable future. Managers cannot be expected to play the same independent role in a company controlled by a large owner as in the corporation with dispersed shareholders. To the extent that management has been separated from ownership, the main issue is excessive intervention by the controlling shareholder, not by minority investor, in management.

The main conflict is thus between the controlling shareholders and minority investors. Only controlling shareholders have sufficient incentives to monitor management, but they may also be able to extract private benefits, even at the expense of minority investors. As we have seen, many countries allow various mechanisms for separating control from ownership (eg through dual class shares or pyramiding), in order to encourage monitoring. But these mechanisms also increase the incentives to dilute the claims of other shareholders. In environments with weak institutions, like most transition countries, regulation alone will not be sufficient to constrain management, increasing the need for stronger corporate governance.

Regulatory measures could be designed to promote takeovers by shifting the takeover premium to the bidder (eg the so-called break-through rule proposed by a recent expert group appointed by the Commission). While such measures have desirable features in terms of promoting hostile takeovers, they may also undermine the incentives to hold controlling

[31] A Berle and G Means, *The Modern Corporation and Private Property* (New York, Harcourt, Brace & World, 1932).
[32] M Burkart, D Gromb and F Panunzi 'Large Shareholders, Monitoring, and the Value of the Firm' (1997) 112 *Quarterly Journal of Economics* 693–728.

blocks, and thus weaken shareholder monitoring of management.[33] With strongly concentrated ownership and control, markets for takeovers and proxy fights are likely to be ineffective in any case. Moreover, while takeovers may help corporate governance, they also suffer from their own agency problems. In the transition countries, we should not expect too much from the market for corporate control as a disciplining device.

Large blockholders and the market for corporate control are not the only mechanisms for disciplining managers. Other devices include shareholder litigation and proxy fights, but they are unlikely to be effective, or reliable, in the transition environment with weak courts and concentrated shareholdings. Boards of directors cannot be expected to play an independent role in companies controlled by a single shareholder. Executive compensation schemes are yet another way to align the incentives of management with those of the firm. However, as the Enron experience suggests, it is a highly imperfect mechanism, particularly in transition environments where input numbers are highly volatile and even more subject to manipulation by managers than in developed market economies.

The corporate governance systems will have to rely on active involvement and monitoring by large blockholders for the foreseeable future, even after the emergence of a class of professional managers. With the possible exception of what can be achieved through executive compensation schemes, none of the other mechanisms are likely to provide significant leverage on management any time soon. In the medium term, there is some hope that large commercial banks will start to play a more active role in financing and monitoring companies, but this has not happened yet.

Moreover, experience from transition countries suggests that controlling shareholders (strategic investors) are critical to successful restructuring of privatised firms. Foreign direct investment, where (by definition) investors take controlling positions, has been particularly important. Some countries have seen considerable inflows of portfolio (minority) capital, but these flows are more volatile and very sensitive to investor protection. There are, however, also examples of portfolio investors, like the Hermitage Fund in Russia, that have successfully specialised in investing in severely discounted shares and then pushing for improved overall minority protection to raise the value of their shares.

Minority protection is important to attract outside capital, but it may reduce the disciplinary role of the market for corporate control. In particular, the mandatory bid rule requiring that any control premium is shared equally among the controlling owner and minority shareholders could seriously reduce the probability of a hostile offer. When ownership is dispersed, no control premium is paid and the mandatory bid rule essentially has no effect. But when

[33] E Berglöf and M Burkart, 'European Takeover Regulation' (2003) 18 *Economic Policy* 171–214.

ownership is concentrated, this rule intended to protect minority investors against diluting takeovers unfortunately increases the cost of a takeover, potentially even enough to make the minority shareholders worse off.

Sales of large blocks are desirable and critical to successful corporate restructuring in these countries, but the mandatory bid rule essentially closes down the market for block trades. Moreover, since a mandatory bid rule reduces the likelihood that a bid will be made in the first place, it entrenches the incumbent controlling owner, and diminishes any disciplining role the market for corporate control may have. Given that transition countries will have concentrated ownership for the foreseeable future, the mandatory bid rule, at least not in its strict form leaving no control premium, does not seem to be part of an optimal regulatory environment. Several of the countries in Central and Eastern Europe seem, however, to have found ways to mitigate the effects of these, largely externally, imposed rules.

In constraining controlling owners and managers, law makers can intervene or rely on self-regulation among the concerned parties. Both methods have their costs and benefits, and the tradeoff between them has been accentuated by the recent flurry of voluntary corporate governance codes. Self-regulation probably has greater legitimacy among those constrained by the rules, and is very flexible in a rapidly changing technological environment where government rules easily become obsolete. Government regulation has more bite and probably broader legitimacy in the rest of society. Unfortunately, self-regulation is unlikely to be effective in weak transition environments, but enforcement of government regulation is also more unreliable. Nevertheless, government regulation is necessary to convince large, particularly foreign, investors to commit substantial amounts of capital. Self-regulation is also unlikely to work unless there is government regulation as a strong credible threat in case compliance breaks down. The focus of regulation should be on reducing the scope for fraud resulting in the exploitation of minority shareholders.

The many corporate governance codes have served other purposes. They have been quite useful in promoting debate and thus fostered awareness of the underlying issues. They have also allowed some degree of commitment to good behaviour. There should be some cost to breaking a well-specified code rather than some general ethical rule. Perhaps most importantly, the codes serve as useful reference points in bargaining on boards of directors and between controlling shareholders and minority investors. Managers and controlling owners will have to explain when they deviate from the standard, thus shifting status quo in the discussion. Historically, codes were a first step towards binding regulation (compare, for example, the US experience).[34] Government regulation can be challenged in courts and thus

[34] J Coffee 'Do Norms Matter? A Cross-country Examination of Private Benefits of Control' (2001) 149 *University of Pennsylvania Law Review* 2151–2177.

promotes court development. Under both forms of regulation, independent media plays an important role in bringing out abuses and supporting enforcement. In many of the Central and Eastern European countries, investigative business journalism is still in its infancy.

In spite of tremendous institutional differences, corporate governance codes around the world are remarkably similar across developed, transitional and developing countries. This observation suggests either that there are considerable costs to deviating from these codes, but also that the codes are not (at least not yet) very effective. It also highlights yet another tradeoff: that between harmonisation and self-definition of the corporate governance problem. Codes are easy to import, even easier than recommendations and binding regulations from governments, but they are much harder to enforce if they do not come out of self-definition. Simple emulation will not foster such a process, and may in fact even be counterproductive to corporate governance reform when rules are not adjusted to local conditions. We argue that self-definition is, in fact, part of the solution to the problem of enforcement. When legislators and enforcing agencies have been part of the genesis of the rules, they are more likely to continue to develop and enforce the rules. Just as in the individual firm, imported codes can serve as a useful reference point in the national regulatory process; any deviations would have to be explicitly motivated by local conditions.

CONCLUSIONS

Recent scandals like Enron and Worldcom have shown that the externalities imposed by governance failures in individual companies reflect on the entire financial system in a country, even in countries with highly developed institutions like the United States. The emerging capitalist systems are facing similar but far more difficult challenges. In an increasingly global financial system these fledgling regulatory environments are competing for international savings. But the ability to attract foreign capital, both direct and portfolio investment, is only one important consideration in the design of a financial system; it must also generate domestic savings. In this system, corporate governance is critical. We have outlined the many difficult tradeoffs involved in corporate governance reform in Central and Eastern Europe. Our main message is that ownership and control is and will remain concentrated for the foreseeable future, and regulatory intervention should focus on eliminating outright fraud while maintaining the incentives for entrepreneurship and large shareholder monitoring. In particular, there is a strong need to make the emerging control structures and what controlling owners do more transparent.

Regulators must recognise that large blockholders are an important feature of the corporate governance system once ownership and management

separate. Controlling shareholders are a second-best response to weak legal institutions. Efforts to get rid of large holdings would lead to more managerial discretion in an environment where there are very few other disciplining mechanisms and where sediments of a specific stakeholder culture may obfuscate corporate goals. Moreover, such attempts would not go unanswered. They would most likely lead to further de-listings and increased opaqueness. The market for corporate control is critical to promote transfers of controlling blocks but given the high ownership concentration these transactions are unlikely to take place against the desire of the controlling shareholders and managers. Strict enforcement of mandatory bid rules would essentially shut down the market for corporate control and further entrench incumbent management and controlling owner.

Empowering (minority) shareholders is still important, since it promotes liquidity in stock markets, which, in turn, provides capital and valuable information for corporate governance and restructuring. Corporate governance codes are useful, but more binding legislation is necessary. Perhaps the single most important objective is to increase transparency, not only about ownership and control structures, but also about what managers and controlling owners do, in particular how they reward each other. In this regard, the countries of Central and Eastern Europe have an opportunity to leapfrog the developed markets on the European continent where transparency is still wanting. Even strengthening the legal recourse of minority investors could eventually help promote good corporate governance. In the longer term, the combined effects of these mechanisms can also help improve contestability of control, critical in disciplining controlling shareholders and managers and giving new owners and management teams an opportunity to bring about much needed restructuring.

References

Barca, F and Becht, M (2001) *The Control of Corporate Europe* (Oxford, Oxford University Press).

Becht et al (2002) 'Report to the Commission from ECGN/EAST BEEPS study, 1999' *World Bank*.

Berglöf, E and Bolton, P (2002) 'The Great Divide And Beyond — Financial Architecture in Transition' 16 *Journal of Economic Perspectives* 77.

Berglöf, E and Burkart, M (2003) 'European Takeover Regulation?' 18 *Economic Policy* 171.

Berle, A and Means, G (1932) *The Modern Corporation and Private Property* (New York, Harcourt, Brace & World).

Black, B S, Kraakman, R and Tarassova, A S (1998) *Guide to the Russian Law on Joint Stock Companies* (The Hague, Kluwer Law and Taxation Publishers, International).

Burkart, M, Gromb, D and Panunzi, F (1997) 'Large Shareholders, Monitoring, and the Value of the Firm' 112 *Quarterly Journal of Economics* 693.

Claessens, S, Djankov, S and Klingebiel, D (2000) 'Stock Markets in Transition Economies' *The World Bank* (Financial Sector Discussion Paper no 5, September).

Coffee, J (2001) 'Do Norms Matter? A Cross-country Examination of Private Benefits of Control' 149 *University of Pennsylvania Law Review* 2151.

Djankov, S, and Murrell, P (2002) 'Enterprise Restructuring in Transition: A Quantitative Survey' *Center for Economic Policy Research* (Discussion Paper no 3319).

Earle, J, Kaznovsky, V, Kucsera, C and Telegdy, A (2001) 'Corporate Control in Romania' Part of the ACE project *Corporate Governance and Disclosure in the Accession Process* (Unpublished Manuscript, Contract no 97-8042-R).

European Bank for Reconstruction and Development (EBRD), Transition Reports 1995–2001.

Frishberg A, Rabij, M and Loufer, A (1994) *Practical Guide to Ukrainian Corporate and Foreign Investment Legislation* (The Hague, Kluwer Law and Taxation Publishers, International).

Kaufmann, D, Kraay, A and Zoido-Lobaton, P (2002) 'Governance Matters II: Updated Indicators for 2000/01' *The World Bank* (Policy Research Working Paper).

La Porta, R, Lopez-de Silanes, F, Shleifer, A and Vishny, R (1997) 'Legal Determinants of External Finance' (LLSV) 52(3) *Journal of Finance* 1131.

La Porta, R, Lopez-de Silanes, F, Shleifer, A and Vishny, R (1998) 'Law and Finance' (LLSV) 106 *Journal of Political Economy* 1113.

Olsson, M (2001) 'Adopting the Acquis Communautaire in Central and Eastern Europe: a report on the transposition and implementation of the so-called Large Holdings Directive (88/672/EEC)' *European Corporate Governance Network* (Unpublished Manuscript).

Olsson, M, Brzica, D, Fidrmucova, J and Hromkova, L (2001) 'A survey of corporate governance and disclosure rules in the Slovak and Czech Republics' Part of the ACE project *Corporate Governance and Disclosure in the Accession Process* (Contract no 97-8042-R).

Pistor, K (2000) 'Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies' 1 *European Business Organisation Law Review* 59.

Pistor, K, Raiser, M and Gelfer, S (2000) 'Law and Finance in Transition Economies' 8 *The Economics of Transition* 325.

Tamowicz, P and Dzierzanowski, M (2001) 'Ownership and Control of Polish Corporations' *Gdansk Institute for Market Economics*.

Tchipev, P (2001) 'Ownership Structure and Corporate Control in Bulgaria' (Paper presented at the First Meeting on the South East Europe Corporate Governance Roundtable, Romania, 20–21 September 2001).

14

Enhancing Corporate Governance in the New Member States: Does EU Law Help?

KATHARINA PISTOR

INTRODUCTION

AFTER THE FALL of the Berlin wall in 1989 the former socialist countries of CEE that are now set to become members of the European Union faced the formidable task of transforming their economies from centrally planned economies to economies that were primarily based on market principles. This entailed the privatisation of the former state owned sector and the implementation of legal and institutional reforms to enhance corporate governance.[1] The EU has admitted eight of the transition economies as new Member States (TEMS)[2] after having attested that they have fulfilled the necessary conditions. The country reports completed prior to the Council meeting in Copenhagen in December 2002[3] confirmed that these countries are now functioning market economies and able to withstand the competitive pressures of market forces once they join the EU.[4] According to data available from the European Bank for

[1] M Aoki and H-K Kim, *Corporate Governance in Transitional Economies (*Washington, The World Bank, 1995); R Frydman *et al*, *Corporate Governance in Central Europe and Russia* (Budapest, Central European University Press, 1996); E Berglöf & E-L von Thadden, 'The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries' (1999) *Proceedings of the Annual Bank Conference on Development Economics*.

[2] See the Treaty Concerning the Accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic to the European Union, signed in Athens on 16 April 2003 [2003] OJ L236/46.

[3] The reports for the different countries are available at: — 'Towards An Enlarged Union' Enlargement and Phare Information Centre <http://europa.eu.int/comm/enlargement/report2002/#report2002> (21 August 2003).

[4] The report on Poland, for example, states in s 2.1 (p 33) that 'Poland is a functioning market economy.' Further that 'Poland has completed transition reforms in terms of trade and price

Reconstruction and Development (EBRD) private sector share of GDP is on average 75.6 per cent.[5] The country reports also state that these countries have complied with the *acquis communautaire* (AC), in particular that they have brought their corporate laws and core financial market regulation in line with existing EU law.[6]

The question these reports do not address, however, is the relation between compliance with the AC on the one hand, and the quality of emerging corporate governance systems in the TEMS on the other. This paper seeks to explore this gap by identifying the challenges TEMS face today for creating effective corporate governance systems and compare these challenges with the solutions offered by the AC. For the purpose of this analysis, the paper distinguishes between two levels of corporate governance. The first level comprises the classic problems of corporate governance, ie the allocation of substantive and procedural rights among different stakeholders of the firm (ie shareholders, creditors, employees, management) in a manner that enhances a firm's ability to use resources efficiently and thereby enhance its position in competitive markets (firm level governance). The second level, the institutional foundation for corporate governance (institutional corporate governance), refers to enforcement mechanisms such as judicial recourse and regulatory oversight, which underpin firm level governance. Empirical evidence has corroborated the importance of institutional corporate governance. In a study that replicates and expands on earlier studies by La Porta *et al*[7] for transition economies, Pistor, Raiser and Gelfer found that there was little correlation between changes in the law on the books that strengthened shareholder and creditor rights on the one hand, and indicators for financial market development on the other. By contrast, indicators that capture the effectiveness of legal institutions were strongly correlated with financial market development.[8] In short, the paper

liberalization, is well advanced in privatisation, and has made considerable advances in second generation reforms' (the latter referring to the introduction of health care, education and pension systems). Concerning structural reforms, the report states on p 39 that 'More than 3 million private sector firms now produce over 70% of GDP, compared to about 65% five years ago, and employ more than 70% of the workforce.' Moreover, 'there are no significant legal or institutional barriers to the establishment of new firms in Poland' and 'in general property rights are established and transferable.' (*ibid*).

[5] Data from the end of 2003. The data range from 65% in Slovenia and Lithuania to 80% in the Czech Republic, Poland, Hungary, and Slovakia.

[6] The EU report on Poland attests that since the last report was made the country has witnessed 'further progress with regard to company law…', even though 'legislative progress had been greater than progress in enforcement and implementation.' The report concludes that despite 'some inconsistencies' with the AC, in particular the level of court fees charged for copies from the company register, 'company law could not provide an obstacle to accession.' See EU Regular Report on Poland, 9 October 2002 at 62.

[7] R LaPorta et al, 'Law and Finance' (1998) 106 *Journal of Political Economy* 1113.

[8] K Pistor *et al*, 'Law and Finance in Transition Economies' (2000) 8 *The Economics of Transition* 325.

addresses two closely related questions: First, does the AC enhance firm level corporate governance in light of the major governance problems faced by firms in TEMS today? And second, does the AC further institutionalize corporate governance for firms that originate in TEMS?

CORPORATE GOVERNANCE CHALLENGES IN TEMS

The key challenge for any economy is to optimise corporate governance mechanisms given the agency problems firms in that economy face. A widely accepted definition of corporate governance is that it is 'a system that provides a set of mechanisms designed to control the fundamental agency problem between management and shareholders.'[9] More broadly, Shleifer and Vishny define corporate governance 'as ways in which suppliers of finance to the corporation assure themselves of getting a return on their investment.'[10] These definitions make two important assumptions. First, they assume a separation of ownership and control[11] where shareholders as owners of the corporate enterprise try to control their agents, ie management, which exercises de facto control. Second, they assume that shareholders are the primary providers of firm finance.

These assumptions reflect the experience of the U.S. corporate governance system, but may not be quite as pertinent where ownership structures look quite differently and firms receive financial resources through other channels. For a comparative analysis of corporate governance systems it may therefore be useful to broaden the definition and define corporate governance as a system of mechanisms that reduces major agency costs in the firm wherever they may arise, and ensures that suppliers of crucial inputs to the firm obtain a return on their investments. This definition is open to a broader stakeholder model and captures agency problems not only between management and shareholders, but also between minority shareholders and blockholders, creditors and shareholders, or even employees and shareholders. It follows Hansmann's analysis of the ownership of enterprise.[12] As Hansmann has shown, depending on the relative costs of market-based contracting for various inputs, the optimal allocation of control rights to different stakeholders (or patrons) may well differ not only from sector to

[9] E Berglöf and A Pajuste, 'Emerging Owners, Eclipsing Markets?' ch 13 in this volume, following M Becht and A Röell, 'Corporate Governance and Control' *European Corporate Governance Institute* (ECGI Working Paper Series in Finance no 2, 2002).
[10] A Shleifer and RW Vishny, 'A Survey of Corporate Governance' (1997) LII *The Journal of Finance* 737.
[11] A A Berle and G Means, *The Modern Corporation and Private Property* (New York, Columbia University, 1932).
[12] H Hansmann, *The Ownership of Enterprise* (Massachusetts, Belknap Press of Harvard University Press, Cambridge, 1996).

sector, but also from country to country and firm to firm. This approach also has the benefit of accounting for the possibility that corporate governance is a moving target. The relative costs of different inputs and/or the costs of monitoring may change, and as a result a reallocation of control rights to different stakeholders may be warranted. If, for example, the value of human capital in a particular firm is higher than financial capital, as posited by Zingales in his account of the 'new firm'[13], a governance structure that focuses exclusively on ensuring high returns to financial investors may be misplaced. Closer to the experience of many transition economies, when ownership is highly concentrated and there is little separation of ownership and control, legal rules that attempt to solve the agency problem between shareholders and managers may be of little relevance.

To assess the relevance and likely impact of the governance system established by the AC, it is therefore important to take a closer look at governance problems in TEMS. We posit that TEMS face three major governance problems today: Blockholder control, continuing state ownership, and weak institutional governance.

Blockholder Control

Evidence from TEMS suggests that the location of the major agency problem today is between blockholders who typically control management, and minority shareholders. As Berglöf and Pajuste[14] show in their contribution, the corporate landscape in TEMS is characterised by highly concentrated ownership. The median stake held by the single largest owner in the biggest companies for which data is available in the eight TEMS amounts to 45.4 per cent on average.[15] The three largest shareholders together hold on average over 67 per cent of the companies in their sample. Moreover, voting blocks may often exceed the concentration of ownership stakes.

This ownership structure does not suggest a serious separation of ownership and control between major shareholders and management. It does, however, suggest that minority shareholders are frequently at the mercy of blockholders. Indeed, there is substantial evidence that blockholders have used their de facto control in newly privatised companies to expropriate minority shareholders by looting company assets or diverting them to newly established subsidiaries under the control of management, which in turn serves the interests of management and/or the dominant blockholder — a

[13] L Zingales, 'In Search of New Foundations' (2000) 55 *Journal of Finance* 1623.
[14] E Berglöf and A Pajuste, n 9.
[15] Note that data are typically available for listed companies. In unlisted companies, which may include some of the larger firms in an economy, ownership concentration tends to be even higher.

practice referred to as tunneling.[16] Blockholder control is not unique to TEMS, but is also a core feature of the ownership structure in most continental European economies.[17] Measuring the ultimate voting block rather than ownership stakes, Becht and Roell show that in seven continental European jurisdictions (Austria, Beglium, France, Germany, Italy, Spain and the Netherlands), the median concentration of voting rights is 45.7 per cent. Given the prevalence of block ownership in current Member States of the EU, it is worth exploring whether existing EU law on corporate governance addresses the problems that arise from this ownership structure. If that was the case, the AC could greatly contribute to improving corporate governance in TEMS.

A slightly more unique feature of TEMS is that the new shareholders have often contributed little or nothing to the firm's finances. In countries where mass privatisation programs were implemented, shareholders obtained vouchers for free or for a nominal amount from the state and could use these vouchers to acquire shares in companies. Of the eight TEMS, six have used mass privatisation programs to a greater (Czech Republic, Latvia, Lithuania, Slovenia, Slovakia) or lesser (Poland) extent, while only Hungary and Estonia have relied almost exclusively on traditional forms of privatisation. Where shareholders have not contributed to firm financing in the past, there are few incentives for those who control the firm's affairs to serve the interests of shareholders, as their future contribution to the firm is uncertain. An important task of corporate governance systems in these countries is not to ensure current shareholders a return on their investment (as from the firm's perspective they have not invested anything), but to prevent looting by some at the expense of others. While some have argued that looting is simply part of the process of reallocating property rights and that once 'real owners' have emerged, they will demand better protection of their property rights,[18] looting may seriously undermine investors' confidence in financial markets and thus have longer term detrimental effects for corporate governance and financial market development.

So far, most firms in transition economies have avoided the use of external sources of funds. Available evidence suggests that firms finance new investment projects primarily through retained earnings.[19] Initial public offerings as well as secondary offerings have been rare, and equity, and — to a

[16] J Coffee, 'Privatisation and Corporate Governance: The Lessons from Securities Market Failure' (1999) 25 *Journal of Corporation Law* 1; S Johnson et al, 'Tunneling' (2000) 90 *American Economic Review* 22. For even more dramatic accounts of tunneling practices, cf below Black, n 24 and below Fox, n 36.

[17] M Becht and A Roell, 'Blockholdings in Europe: An International Comparison' (1999) 43 *European Economic Review* 1049.

[18] P Boone and D Rodionov, 'Rentseeking Russian Style' (Unpublished manuscript 2001).

[19] The European Bank for Reconstruction and Development (EBRD), 'Transition Report — Financial Sector in Transition' (London, EBRD, 1998); E Berglöf and A Pajuste, ch 13 in this volume.

somewhat lesser extent – debt markets in most transition economies remain underdeveloped when compared with countries at similar levels of GDP.[20]

This evidence does not imply that firms do not have a greater demand for outside sources of finance than they currently reveal, ie that they would not be better off if they were making greater use of outside sources of finance. The lack of external sources of funds for companies in transition economies as further evidenced by the absence of a vibrant IPO market, appears to be as much a demand as a supply problem.[21] While outside investors may be reluctant to invest in firms absent better protection of their rights,[22] an alternative explanation may be that those currently in control of firms may have little desire to access capital markets for fear that this might dilute their control rights. Moreover, they may gain more from looting existing assets than investing in future performance with uncertain outcomes.[23] The primary task therefore is to create incentives or mechanisms for existing blockholders to reduce their control rights (ie by making control rights costly) as a prerequisite for greater demand for outside sources of finance. At the very least, the creation of additional incentives to further the concentration of ownership and voting control should be avoided.

State Ownership

A second important feature of TEMS is continuous state ownership and state control over partially privatised firms. While privatisation has made substantial headways in TEMS over the past 13 years, the process is by no means complete. In many 'privatised' companies the state retains a substantial ownership stake of about 20–25 per cent and in key industries this may be accompanied by veto rights for major changes, including change in control. State ownership is likely to remain comparatively high for some time to come. The process of privatisation has slowed down and the case for privatisation today is less forcefully made than in the early years of transition.[24] While there is substantial evidence that privatised firms perform

[20] K Pistor, *et al*, above n 8.
[21] K Pistor, 'Law as a Determinant for Stockmarket Development in Eastern Europe' in P Murrell (ed), *Assessing the Value of Law in Transition Economies* (Ann Arbor, University of Michigan Press, 2001).
[22] A Shleifer and R W Vishny, above n 10.
[23] B Black *et al*, 'Russian Privatisation and Corporate Governance: What Went Wrong?' (2000) 52 *Stanford Law Review* 1731.
[24] According to data obtained from the EBRD Transition Reports, the average private sector share of GDP increased between 2000 and 2002 only marginally in the acceding new Member States, from 73% to 75.6%. Compare transition indicators in the 2001 and 2003 reports.

better than state owned firms,[25] privatisation has not proved to be a miracle cure for ailing state owned companies and this has dampened the appetite for continuing privatisation programs at a rapid pace.

State ownership may affect firm level governance in various ways.[26] Even if the state has relinquished majority control, it may reserve veto rights over key decisions for state agents and ensure that state representatives sit on company boards so that they can influence corporate decision-making. Moreover, passive state ownership may also influence corporate decision making by providing insurance against misguided corporate strategies. The state will have to assume its share of the costs of high risk strategies that other shareholders or management may adopt, knowing that they will have to foot only part of the bill. Finally, the state as owner is likely to bail out firms in case they face insolvency. As a result, continuing state ownership may distort investment decisions. These distortions should be minimised.

Law Enforcement

One of the most pressing problems in transition economies is lack of effective law enforcement. All transition economies have made substantial progress in reforming their laws on the books. Actual progress in financial market development, however, has hinged more on the effectiveness of law enforcement than on changes in the law on the books.[27] Survey data compiled by the EBRD on the extensiveness and effectiveness of law reforms document that the two indices continue to diverge.[28] While most of the Central and Eastern European countries have implemented extensive legal reforms in areas relevant for the corporate and financial sectors, the actual implementation or effectiveness of these reforms frequently lags behind.[29]

The most important legal mechanisms for enforcing corporate governance are judicial review and regulatory oversight. So far, courts have not played an important role in specifying the obligations of relevant stakeholders in

[25] R Frydman *et al*, 'When Does Privatisation Work? The Impact of Private Ownership on Corporate Performance in Transition Economies' 114 *Quarterly Journal of Economics* 4: 1153. For a comprehensive survey of the empirical evidence on privatisation compare W Megginson and J M Netter, 'From State to Market: A Survey of Empirical Studies on Privatization' (2001) 39 *Journal of Economic Literature* 2: 321.

[26] K Pistor and J Turkewitz 'Coping with Hydra — State Ownership in Central Europe and Russia' in C Gray, R Frydman and A Andrzej Rapaczynski (eds), *Corporate Governance in Central and Eastern Europe* Vol 2 (Budapest, CEU Press, 1996) 192-246.

[27] K Pistor, *et al*, above n 8.

[28] EBRD, *Transition Report: Energy in Transition* (London, EBRD, 2001).

[29] The EBRD uses a scale from 1 to 4 with '+' and '-' For the Czech Republic, the extensiveness is rated '3+', effectiveness '3'; for Estonia the equivalent data are '4' and '3', for Lithuania '3+' and '4-', for Poland '4' and '3', and for Slovenia '4' and '4-'. For Hungary, Latvia, and the Slovak Republic the ranking is identical for both categories.

the corporation. Case law has been rare or absent for most TEMS.[30] The performance of regulators as monitors and law enforcers differs substantially from country to country. The most widely studied cases are Poland and the Czech Republic and commentators overwhelmingly agree that the Polish financial market regulator has been more effective than the Czech Regulator - with notable effect on market performance.[31]

Whatever the causes for the — relatively[32] — weak track record of TEMS in law enforcement, the phenomenon gives rise to the question of whether a possible solution to this problem is to encourage firms to opt out of the weak domestic governance system and opt into more effective rules and enforcement mechanisms elsewhere. International financial market integration has facilitated cross-listings and migration of firms from home to host markets. While cross-listing could be primarily driven by the desire to benefit from greater liquidity in the host market, there are strong arguments and empirical evidence to support the proposition that 'migration' is used to, or at least has the effect of, signaling to investors at home and abroad that firms wish to bind themselves to more rigorous regulatory standards.[33] More generally, some scholars have suggested that firms should be allowed to freely opt into securities regulations of different jurisdictions and thereby piggyback on the superior enforcement systems in other countries.[34]

Even if one does not subscribe to these suggestions in general, given the importance of institutional governance for firms' costs of raising capital, it is at least conceivable that migration may enhance institutional governance for firms from TEMS. An alternative strategy is to induce domestic governments to enhance their law enforcement institutions. This strategy is

[30] K Pistor and C Xu, 'Fiduciary Duties in (Transitional) Civil Law Jurisdictions — Lessons from the Incompleteness of Law Theory' in C Milhaupt (ed), *Global Markets, Domestic Institutions: Corporate Law and Governance in a New Era of Cross-Border Deals* (New York, Columbia University, 2003) 77.

[31] J Coffee, above n 16; S Johnson and E Glaeser *et al*., 'Coase vs. Coasians' (2001) 116 *Quarterly Journal of Economics 3: 853*; K Pistor (2001) above n 22.

[32] To be sure, law enforcement in most Central and Eastern European countries is substantially better than in those of South-Eastern Europe or the former Soviet Union. See Pistor *et al.* above n 8.

[33] J Coffee, 'Racing Towards the Top? The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance' (2002) 102 *Columbia Law Review* 1757; J Coffee, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2002) 111 *Yale Law Journal* 1; E Rock, 'Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure' (2002) 23 *Cardozo Law Review* 675. See also L Klapper and I Love, 'Corporate Governance, Investor Protection and Performance in Emerging Markets' *World Bank Policy Research* (Working Paper 2818 March 2002), who show that firms from 'bad' governance regimes can escape the negative shadow of such a regime by voluntarily complying with superior governance standards, including voluntary codes of conduct.

[34] S J Choi and A T Guzman, 'Portable Reciprocity: Rethinking the International Reach of Securities Regulations' (1998) 71 *South California Law Review* 903; R Romano, 'Empowering Investors: A Market Approach to Securities Regulation' (1998) 107 *The Yale Law Journal* 2359.

supported by those who advocate allocating regulatory control to a firm's country of origin.[35] Whatever the preferred strategy on theoretical grounds, institutional governance in TEMS is in need of reform. This paper will therefore scrutinise the harmonisation of financial market regulation embodied in the AC for strategies that may advance this goal.

FIRM LEVEL GOVERNANCE UNDER THE AC

Firm level governance includes all mechanisms designed to lower agency costs among different stakeholders of the firm, and to ensure adequate returns for those providing major inputs to the firm. The following discussion will focus on three major aspects of firm level governance: internal governance, transparency, and external governance. Internal governance refers to the allocation of control rights inside the corporate enterprise, including the allocation of rights between management and shareholders and among different shareholder groups, which is commonly achieved by quorum requirements, majority voting rules, or veto rights. Transparency includes disclosure requirements of listed and unlisted firms that enhance the ability of investors to assess company performance and thus the risks of their investment decisions. Finally, external governance refers to governance mechanisms that strengthen the market for corporate control. The discussion will focus only on mechanisms that are explicitly provided for in EU directives on undertakings or financial markets and will select only those for more detailed discussion that appear to be relevant for TEMS in light of the corporate governance challenges identified above.

Internal Governance

EU community law has not produced a coherent legal framework for internal governance — despite major efforts that have been devoted to the harmonisation of company law over the past 35 years.[36] The core features of such

[35] MB Fox, 'U.S. Perspectives on Global Securities Market Disclosure Regulation: A Critical Review' (2002) 3 *European Business Organization Review 337;* MB Fox, 'Retaining Mandatory Securities Disclosure: Why Issuer Choice is not Investor Empowerment' (1999) 85 *Virginia Law Review* 1335.

[36] The First Council Directive of 9 March 1968 was based on Art 54 (3) (g) (now Art 44 (2) (g) of the TEU), which provides for the 'coordination of safeguards, which, for the protection of the interests of members and others, are required by Member States of companies or firms (…) with a view to making such safeguards equivalent throughout the Community.' Council Directive 68/151/EEC of 9 March 1968 on Co-ordination of Safeguards which, for the Protection of the Interests of Members and Others, are Required by Member States of Companies within the Meaning of the Second Paragraph of Art 58 of the Treaty, with a View to Making Such Safeguards Equivalent Throughout the Community (First Company Law

a system were included in the 5th Council Directive, which failed, mostly because it called for a mandatory two-tier management structure and, even more importantly, employee co-determination along the lines of the German model. These features have failed to find sufficient support among the other Member States. Other parts of the directive, which address the internal allocation of control rights in the firm, including voting rights, quorum and majority requirements for shareholder votes, rules on the appointment and dismissal of the members of the corporate board(s), and the respective functions of the management and supervisory boards, were doomed together with these highly contentious parts of the directive.

Some internal governance devices can now be found in the regulation of the Societas Europaea (SE), which was adopted after an over 40-year gestation period in October 2001. These provisions, however, have no direct bearing on any company, unless and until it joins another corporation located in a different Member State to establish an SE.[37] While some commentators have suggested that the SE may change the landscape of corporations in the EU in the future and introduce substantial amount of competition,[38] there are reasons to be more cautious about this assessment. The SE regulation does not offer a fully developed governance structure, but refers in many instances to the national law of the Member State where the SE is registered. Moreover, the SE must be located within the Community in the same Member State as its head office and Member States may require the SE to have their head office and place of registration in the same state (Article 7).[39] The SE statute provides that in case a company fails to comply with the requirements of Article 7, the relevant registration authorities may demand that it either moves its headquarters or its registered office in accordance with the SE statute and may sanction any infringement of said provisions (Article 64). The implication of these provisions for companies from TEMS is that they may benefit from whatever superior governance structure the SE has to offer, only if they become part of an SE that is registered in and therefore subject to the law of a different Member State with a better governance structure. Finally, establishing an SE can be a protracted process. An SE can be established only when the

Directive) [1968] OJ L 65/8. For an overview of the history of company law harmonisation in the EU, see Doralt and Kalss, chapter 11 in this volume.

[37] For the formation of an SE, cf Art 2, which sets forth that an SE can be formed only by at least two corporate entities from at least two different Member States.

[38] See J Plender, 'Continental capitalism à la carte' *Financial Times* (London, UK, 21 February 2003) 13. See also L Enriques (2003) 'Silence is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage' *European Corporate Governance Institute* (ECGI Working Paper Series No 7 2003).

[39] This endorsement of the seat theory appears at odds with recent ECJ case law that seems to curtail the scope of the so-called seat theory. See in particular Case C-208/00 *Ueberseering BV v Nordic Construction Company Baumanagement (NCC)* [2002] ECR I-9907.

employees of the companies that will constitute the SE have come to an agreement with the management of the respective companies about the future participation of employees.[40] While the Statute on the SE sets a time limit of six months and a maximum of one year for the negotiations, this does not include the time it takes to establish the 'special negotiation body' of employee representatives. Moreover, these requirements may dampen the interest of companies from countries with less comprehensive employee representation to form an SE.

Elements of internal firm governance can, however, be found in other directives. The 2nd Council Directive on capital adequacy,[41] for example, stipulates that the shareholder meeting shall decide on changes in corporate capital (Article 25). Decisions to increase capital or to authorise capital to be issued by directors over not more than five years may be taken by simple majority vote. Decisions concerning capital decreases and waiver of pre-emptive rights, however, require a super majority vote (Articles 40, 29, 30). More generally, the directive mandates that shareholders be given pre-emptive rights when new shares are issued or authorised (Article 29). A pre-emptive right can be waived only by a super majority vote of at least two-thirds of the shareholders, although a simple majority may suffice, if at least 50 per cent of the shareholders are present. The impact of pre-emptive rights on corporate governance is ambiguous. While La Porta et al consider pre-emptive rights as one of the core protections for minority shareholders,[42] depending on the ownership structure of a given firm, the rule may work primarily to the benefit of blockholders.[43] The reason is that pre-emptive rights allow blockholders to retain their control structure, perhaps even at below market price.

The second directive also contains a number of provisions that are widely regarded as creditor protection devices, including the concept of legal capital and minimum capital requirements, as well as provisions that bar a company from buying its own shares except on enumerated conditions (Article 22), or to extend loans for the acquisition of its own shares (Article 23). The level of minimum capital is pitched at 25,000 Euro for publicly traded corporations — an amount which even under the conditions

[40] The procedure for this, including the rules governing the election of employee representatives can be found in: Council Directive 2001/86/EC of 8 October supplementing the Statute for a European company with regard to the involvement of employees [2001] OJ L 294/22.
[41] Second Council Directive EC 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Art 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent [1977] OJ L 026/1 (2nd Company Law Directive).
[42] R LaPorta, above n 7.
[43] K Pistor, (2001) above n 21.

of TEMS hardly raises serious concerns regarding barriers to entry. Not surprisingly, the latest Winter Report II regards reforms in this area as superfluous,[44] even though earlier reports on simplifying company law in the EU have toyed with the idea of raising minimum capital requirements.[45]

More troubling than the amount of minimum capital the 2nd Directive requires is the concept of legal capital as such, and the system the directive has put in place to enforce the concept. As Enriques and Macey suggest, the major beneficiaries of this concept of legal capital may be management, not creditors.[46] Creditors — as they argue and as the Winter Report II confirms — do not pay much attention to legal capital. They are more interested in the firm's future cash flows and tangible assets that could be used as collateral. Yet, firms do not only comply with minimum capital requirements, but set aside large proportions of their retained earnings. The German company Siemens prides itself with legal capital in the amount of € 2.655 billion, and Beiersdorf of € 215 million.[47] This is money the company could have, but has not, paid out to its shareholders.

The concept of legal capital is buttressed by provisions that prevent the use of firm funds to acquire its own shares or, in the case of a subsidiary, of those of its parents (Article 24, 2nd Directive). While there may be good reasons to regulate a firm's ability to freely acquire its own shares, the stringent regulations found in the 2nd Directive make it difficult for firms to use their own assets as collateral for financing acquisition strategies.[48] In fact, these provisions have already caused problems in TEMS when structuring acquisition transactions.[49]

In sum, the AC's record on internal governance is rather mixed. A full blown structure of internal governance does not exist, leaving it to the Member States to design those aspects not explicitly covered by the directives described above.[50] While there are voices that the EU should reconsider

[44] 'Press Release High Level Group of Company Law Experts' *European Commission* <http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/press-comm-group_en.pdf> (Winter Report II of November 2002) (21 August 2003).
[45] E Wymeersch, 'Company Law in Europe and European Company Law' (Financial Law Institute Working Paper Series 2001).
[46] L Enriques and J Macey, 'Creditors vs. Capital Formation: The Case Against the European Legal Capital Rules' (2001) 86 *Cornell Law Review* 1165.
[47] P Mülbert and M Birke, 'Legal Capital — Is there a Case Against the European Legal Capital Rules?' (2002) 3 *European Business Organization Law Review* 695.
[48] T Baums, 'Corporate Contracting Around Defective Regulations' (1999) 155 *Journal of Theoretical and Institutional Economics* 119–27.
[49] I am grateful to Petr Panek for alerting me to such cases. In US merger practice, for example, using a firm's assets to collateralise the financing of an acquisition or buy out is quite common, but such strategies are ruled out by the Directive. In fact, they have been extended to subsidiaries so that they cannot use their own funds or assets to collateralise loans used to acquire the parent either. On the incompatibility of European corporate laws with a vibrant merger market, see also above Baums n 48.
[50] For a positive assessment of the flexibility the harmonised EU thus leaves to old and new Member States, compare Soltysinski in this volume.

regulating the internal governance system of corporations,[51] the recent Winter Report II on the modernisation of European company law cautions against such an approach, and instead advocates the use of more flexible tools, including soft laws, recommendations and standards.

The absence of mandatory rules for the internal governance structure of firms has both costs and benefits for TEMS. On the one hand, it allows them to experiment with different solutions and develop one that best fits their circumstances. On the other, it alleviates the pressure to reform aspects of the internal governance structure, which may be regarded as problematic. The relevant company laws of Hungary[52] and the Czech Republic,[53] for example, provide that both the management board and the supervisory board are elected at the shareholder meeting. This raises doubts about how much leverage the supervisory board has over the management board, as it can neither hire nor fire the members of the management board. Given that the AC has mandated many costly adaptations in TEMS's corporate laws, for which there might be a less strong case, the failure to address actual problems in the design of governance structures is unfortunate.

Transparency

Publicity and disclosure of company information to shareholders and the public at large has been a repeated theme of harmonisation measures at the EU level. The first Council Directive on undertakings standardised the information each corporation had to disclose upon its formation as a corporate entity, and required annual financial reports to be filed with the company register, irrespective of whether the company was listed. Another device to enhance transparency of the corporate sector is the so-called 'Large Holdings Disclosure Directive,' which was adopted in 1988.[54] According to the directive, any acquisition by which the buyer acquires voting rights in a company in excess of 10 per cent, 20 per cent, 1/3, 50 per cent, and 2/3 must be disclosed. Voting rights include not only direct, but also indirect voting

[51] K J Hopt, 'Modern Company and Capital Market Problems — Improving European Corporate Governance after Enron' *European Corporate Governance Institute* (ECGI Working Paper Series 1, 2002).

[52] The Hungarian Law on Enterprises stipulates in Art 233 that the shareholder meeting elects and dismisses the members of the management board, the supervisory board, and the auditors.

[53] See Arts 194 (election of the management board by the shareholder meeting) and 200 (election of the supervisory board by the shareholder meeting) of the Czech Commercial Code.

[54] Council Directive 88/627/EEC of 12 December 1988 on the information to be published when a major holding in a listed company is acquired or disposed of [1988] OJ L 348/62 (Large Holding Disclosure Directive, or LHDD). The directive has meanwhile been incorporated into Council Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities [2001] OJ L 184/01.

rights, including rights held by another entity, which the acquirer controls.[55] The purpose of the directive is to bring some transparency into Europe's corporate landscape, which is characterised by pyramidal ownership and control structures. TEMS, whose corporate structure resembles that of Western Europe, should therefore also benefit from the directive. In fact, all eight TEMS have transposed the large holdings disclosure directive in one way or another.[56] This major success notwithstanding, the experience with the transposition of a measure that can arguably enhance corporate governance illustrates the difficulties of legal harmonisation more generally. All eight TEMS have adopted the directive piecemeal by incorporating it into different statutes that address issues related to the directive. While this ensures that pre-existing differences in all relevant domestic statutes are addressed, it slows down the process of transposing the directive and makes monitoring of proper implementation more difficult. Interestingly, the TEMS were not reluctant in ensuring disclosure of direct voting rights. By contrast, the various forms of indirect voting rights envisaged by the directive and subjected to the same disclosure requirement, have only imperfectly been incorporated in the laws of TEMS. The reason for this may be that in light of the existing control structures of firms in these countries, lawmakers may have seen little justification for the complex set of rules set forth in Article 4 LHDD. Alternatively, they may have wished to signal formal compliance with the directive without displeasing domestic interests that might benefit from less disclosure. More generally, a strategy of formal compliance while acquiescing to domestic interest groups is to include the relevant rules on the books, which can be achieved by adopting laws, but ensuring that law enforcement will not be effective. Indeed, Olsson suggests that lax enforcement is common, which may indeed be part of a conscious 'comply but don't enforce strategy.'[57] Alternatively, lack of enforcement may only reflect objectively weak enforcement institutions in TEMS. In either case, failure to fully comply with a directive is a problem not unique to TEMS, as the delay by Germany to enforce the annual disclosure requirements against privately held corporations for over 20 years suggests.[58] The more general lesson from this experience is that the harmonisation of company law in Europe has been a slow and complex process. While TEMS are forced to adhere formally to the AC, because this is an entry condition for joining the EU, substantive compliance is not assured and will require a combination of efforts by the domestic governments and monitoring by the EU.

[55] See Art 4 LHDD for the scope of indirect control rights captured by the directive.
[56] M Olsson, 'Adopting the acquis communautair in Central and Eastern Europe: A Report on the Transposition and Implementation of the so-called Large Holding Directive (88/627/EEC)' *European Corporate Governance Institute* <http://www.ecgi.org/research/accession/lhd_paper_cee10.pdf> (21 August 2003).
[57] *Ibid*.
[58] See Case C-191/95 *Commission v Germany* [1998] ECR I-5449.

The EU has also adopted several directives that enhance transparency of information for companies that are listed on an organised exchange. In May of 2001, a consolidated directive on the admission of companies for official listing on organised exchanges and the applicable disclosure regime was adopted,[59] which has been amended in 2003 by a new Prospectus Directive.[60] Whereas under the 2001 Directive only companies that seek admission to official listing on a stock exchange were subjected to the disclosure rules, under the new Directive 'any offer of securities to be made to the public' is subject to disclosure requirements (Article 3). This has greatly enhanced the standards for disclosure and reduced the likelihood that firms may avoid stock exchanges when issuing shares to the public in order to avoid transparency.

Continuous disclosure requirements currently demanded under the 2001 directive include the obligation of companies to inform current shareholders of annual meetings, dividend payments (Article 65.2), as well as changes in the corporate charter (Article 66). In addition, the public must be furnished with ad hoc information of major events that may impact the assets or liabilities of the firm (Article 68) and the publication of semi-annual reports on activities, profits and losses (Article 70). Member States may increase the frequency of the reporting requirements, provided that they treat alike all companies or all companies of a given class (Article 71). A new transparency directive, which is currently under discussion, may, among other things, increase reporting frequency to quarterly reporting.[61]

Several TEMS had already increased their standards to the requirements of EU law. Poland, for example, subjects all securities issued to more than 300 investors, not only firms admitted to trading on official exchanges, to registration and basic disclosure requirements.[62] Similarly, the Czech Republic attaches registration and disclosure requirements to publicly tradable securities.[63] The first 10 years of highly volatile market development have driven home the point that financial market regulation is crucial for the development of sustainable financial markets. The Czech Republic has witnessed the most dramatic turnaround. After earlier policies had favoured a laissez faire approach, a securities regulator was finally established

[59] Council Directive 2001/34/EC of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities [2001] OJ L184/01 (consolidated admissions and listing Directive).
[60] See Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading and amending Directive 2001/34/EC [2003] OJ L345/64 (Prospectus Directive).
[61] See the proposal for a 'Directive on the harmonisation of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market' of COM (2003) 138 final (26 March 2003) 2003/0045 (COD).
[62] See Law Arts 2, 61 of the Public Trading of Securities of 1997 as last amended in 2001, *Komisja Papierów Wartosciowych i Gield* 21 August 1997 (available from ISI Emerging Markets Data Base, 30 January 2004).
[63] Art 70, Securities Act of the Czech Republic (available on ISI Emerging Market Data Base).

in 1997 and the rules governing financial markets were revised subsequently.[64] Hungary and Poland had both started the transition period with a much stronger set of regulations in place, which seems to have paid off.[65] In other words, local demand rather than external imposition has driven law development in this area. The most important added value that comes from EU financial market regulation is mutual recognition and the European passport principle, which will facilitate access by companies from TEMS to European markets. However, as will be discussed below, the same mechanisms imply that companies will have a hard time escaping weak domestic regulators by opting into different governance regimes.

External Governance

Governance mechanisms consist of mechanisms that ensure stakeholders a 'voice', as well as of mechanisms that give them an 'exit' right.[66] The most important exit right in a publicly held corporation is the right to freely sell one's shares. The right of shareholders to freely sell their shares is in principle recognised in the company laws of most current Member States. Still, many Member States allow restrictions in corporate statutes. The Winter Report I lists such restrictions among those that can be used as defences against takeovers.[67] A number of TEMS have similar provisions on the books. The Czech Commercial Code, for example, stipulates that registered shares must be freely transferable, but permits that the transfer of bearer shares is made conditional upon approval by one of the 'organs' of the corporation, ie the management board, the supervisory board, or the shareholder meeting.[68] By contrast, the Hungarian Company Law allows restrictions only for closely held corporations.

EU corporate law harmonisation has made little progress over the past 30 years in eliminating or at least reducing corporate law mechanisms that limit exit rights, which arguably protect existing management.[69] The scope

[64] J Coffee, above n 16.
[65] K Pistor (2001) above n 21.
[66] A O Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Cambridge, Mass, Harvard University Press, 1970).
[67] See app 5 of the Winter Report I: 'Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids' European Commission <http://europa.eu.int/comm/internal_market/en/company/company/news/hlg01-2002.pdf>(21 August 2003).
[68] Art 156 V Czech Commercial Code.
[69] The Winter Report lists five different categories of pre-bid defenses currently available under the domestic company law of existing Member States, including (1) barriers to the acquisition of shares in the company, such as ownership caps, restrictions to the transferability of shares, etc; (2) barriers to the exertion of control in the general meeting, including voting caps, shares with double or multiple voting rights, binding voting arrangements and some times of golden shares; (3) barriers to exertion of control in the board of directors, including co-determination, shares with special rights to appoint the directors, supermajority requirements to dismiss

of these mechanisms came to the attention of European law and policy makers in the battle over the 13th Directive on takeovers. Germany ultimately voted against the directive, stressing that the strict board neutrality rule the proposed 13th Directive established, which — absent explicit shareholder approval — limits defensive actions by the target's board to seeking a white knight, would expose German companies to greater takeover threats. The reason was that other countries afforded better pre-bid defenses than Germany did, in particular after it revised its corporate code in 1998. The logic of this argument is that absent a level playing field for companies in all countries of the Union, no company should be exposed to the threat of takeovers without being allowed to defend itself. Getting rid of all pre-bid defenses over a short period of time, however, was impossible – not the least in light of the history of company law harmonisation in the EU. The solution the Winter Report I (January 2002), proposed was a breakthrough rule: Once a bidder had acquired 75 per cent of a target's shares, any legal or statutory provision could be set aside, if it undermined the principle that all shareholders who participate equally in the risk of the company have equal voting rights.

This rather broad rule did not find much support. The proposal for the 13th Directive published in October 2002 now includes a provision that makes only some of the pre-bid defences the Winter Report listed unenforceable vis-à-vis the bidder. In particular, any restriction on the transfer of securities cannot be enforced against the offeror during the period for acceptance of the bid (Article 11.2). Moreover, any restriction on voting rights shall cease to have effect when the general meeting decides any defensive measures after an offer has been made (Article 11.3); or at the meeting following a successful bid, at which the offeror attempts the amend the company's charter (Article 11.4). The most hotly disputed aspect of the new rule is, whether it is appropriate to exclude multiple voting rights from this partial breakthrough rule. Germany and the UK oppose the exclusion, while France, Italy and some of the Scandinavian countries, where multiple voting rights are more common, have lobbied hard for their exclusion. The EU Commission has so far sided with the latter. The introductory commentary states that the provisions about the unenforceability of certain pre-bid defences '… do not concern securities carrying double or multiple voting rights. It can be argued that securities with multiple voting rights form part of a system for financing companies and that there is no proof that their existence renders takeover bids impossible … .'[70]

and/or elect the board; (4) barriers to exertion of control over the assets of the company, including provisions that permit the lock-up of corporate assets; (5) creation of financial burdens as a consequence of the transfer of control, such as poison debt and golden parachutes.

[70] Commission Communication on the proposal for a Directive of the European Parliament and the Council on takeover bids COM (2002) 534 final (2 October 2002) (Proposal) at 9.

The pros and cons of a strict neutrality rule are subject to much debate.[71] In countries without a long history of case law dealing with complicated conflict of interest situations in directors' and officers' decision making, such a bright line rule may indeed be superior to a more nuanced approach to anti-takeover devices.[72] Moreover, a strong case can be made on theoretical grounds for giving more power to the courts to address matters that in Anglo-American systems are labelled fiduciary duty cases, as legislatures are inherently unable to regulate these cases ex ante.[73] However, the European Union has abstained from addressing the related issue of law enforcement in the takeover directive. In fact, the commentary to the directive notes that litigation is undesirable. Moreover, the directive explicitly protects the Member States' prerogative over matters of law enforcement by assuring them that the directive 'shall not affect the power of the Member States to designate judicial or other authorities responsible for dealing with disputes (…) or the power of Member States to regulate whether and under which circumstances parties to a bid are entitled to bring administrative or judicial proceedings.' (Article 4.6 proposed Takeover Directive).

While the case for a break-through rule as general as the one proposed by the Winter Report I may indeed not be overwhelmingly strong,[74] more important for the argument developed in this paper are the lessons the debacle over the 13th Directive holds for corporate governance in the new Member States. In December 2003, the European Parliament finally brought an end to the, more than fourteen year, struggle over the takeover directive by endorsing a compromise suggested by the Portugal.[75] The directive now allows Member States to make it optional for its companies to subject themselves to the above-mentioned takeover regime. In particular, it allows companies to refuse to abide by it should the bidding companies not be bound by similar rules. By implication, a common level playing field for takeovers in Europe has not been established and it will be interesting to observe the Member States' coming out on their commitment to the takeover regime of the 13th directive.

[71] C Kirchner and R W Painter, 'European Takeover Law — Towards a European Modified Business Judgment Rule for Takeover Law' (2000) 1 *European Business Organization Law Review* 353; P O Mülbert and M Birke, 'In Defense of Passivity — On the Proper Role of a Target's Management in Response to a Hostile Tender Offer' (2000) 1 *European Business Organization Law Review* 445.

[72] J Gordon, 'An American Perspective on the New German Anti-takeover Law' *European Corporate Governance Institute* (ECGI Working Paper Series, 2002).

[73] K Pistor and C Xu, above n 30.

[74] See L Bebchuk and O Hart, 'A Threat to Dual-Class Shares' *Financial Times* (London, UK, 31 May 2002), arguing that the rule would reallocate control rights to holders of securities who have acquired them at a discount because they have weak voting rights.

[75] D Dombey, 'European parliament backs takeover directive compromise', *Financial Times* (London, UK, 17 December 2003) 4.

An important lesson from this process is that when it comes to critical issues, corporate governance enhancement in the EU means convergence on the lowest common denominator. Improving domestic governance rules may backfire, as Germany's experience with corporate law reform suggests, because moving ahead of the pack might be a disadvantage, if other countries do not follow suit. A better strategy is to keep all options open until the EU makes the next move and to use these options to mitigate any impact this move might have on domestic interest groups.[76] Viewed in this light, European harmonisation may result in a 'bargain for', rather than a 'race to' the bottom.

For proponents of regulatory competition, this scenario may seem implausible. After all, countries should benefit in the medium to long term by writing corporate laws that will attract companies to incorporate under their jurisdiction.[77] Whether this type of regulatory competition actually works in practice has been seriously challenged by recent empirical studies.[78] Assuming that a case can be made for companies choosing corporate law that best suits them in pursuit of objectives other than maximizing management interests,[79] regulatory competition presupposes that companies can choose their place of incorporation. This has not been the case in large parts of the EU – the Treaty's commitment to the free movement of persons, including legal persons (Articles 43-48 TEU), notwithstanding. A number of current Member States still follow the so-called seat theory, which requires companies to incorporate where their headquarters are. This rule has been reaffirmed by the statute on the SE (see above), but has been seriously challenged by recent case law of the ECJ. In *Centros*,[80] decided in 1999, the court argued that any company that was duly formed under the law of any Member State, had the right to establish branches, subsidiaries, etc in another Member State. The court explicitly denied a Member State

[76] Some TEMS already learnt from experience. Being good students, they incorporated earlier aspects of the 13th Directive into their domestic laws, only to witness the elimination of such provisions from the directive before it even reached the Parliament. Poland, for example, adopted the 33% threshold for mandatory takeover bids in an early revision of its corporate law. See S Soltyskinski, 'Transfer of Legal Systems as Seen by the "Import Countries": A View from Warsaw' in U Drobnig, KJ Hopt, H Kötz and EJ Mestmäcker (eds), *Systemtransformation in Mittel- und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsicherheiten* (Tübingen, Mohr Siebeck, 1998) 69. The draft proposal of the directive now states that it should be up to the individual Member States to determine this threshold.

[77] R K Winter, 'State Law, Shareholder Protection, and the Theory of the Corporation' (1977) 6 *Journal of Legal Studies* 251; R Romano, *The Genius of American Corporate Law* (Washington, AEI Press, 1993).

[78] R Daines, 'The Incorporation Choices of IPO Firms' (2002) 77 *New York University Law Review* 1559-1611; M Kahan and E Kamar, 'The Myth of State Competition in Corporate Law' (2002) 55 *Stanford Law Review* 679.

[79] R Daines, 'Does Delaware Law Improve Firm Value?' (2001) 62 *Journal of Financial Economics* 525.

[80] Judgment of the Court of 9 March 1999. Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459.

the argument that the parent company established in another Member State with more lenient rules was only a shell and that in fact the branch office was the real parent under disguise. Similarly, in *Ueberseering*,[81] the ECJ held that a country following the seat theory could not deny legal personality to a company that had been duly established in another Member State, but had moved its headquarters to that country without re-incorporating. Most recently, the ECJ struck down a law in the Netherlands, which imposed minimum capital and reporting requirements on quasi-foreign companies, ie those registered in another Member State, but doing business primarily in the Netherlands.[82]

These decisions by the ECJ, rather than the highly politicised process of company law harmonisation, may help avoid the bargaining for the bottom in European company law and encourage jurisdictions to move forward with reforms that may make them more competitive in attracting companies for incorporation.[83] More importantly, in order to be able to compete, TEMS must develop and perfect expertise in lawmaking that is both innovative and responsive to business needs. This expertise will also be in demand, if the second Winter Report on Modernizing European Company Law has its way. The report defines the purpose of company law to 'provide a legal framework for those who wish to undertake business activities efficiently, in a way they consider best suited to attain success.' This is quite different from the harmonisation strategy the EU has pursued so far, which was based primarily on the need to safeguard 'members and others' (read 'shareholders and other stakeholders,' Article 44 (2) (g) TEU) and on making these safeguards equivalent throughout the Community. The report proposes standard setting, soft law, and greater flexibility as means to achieve these new goals. Unfortunately, the ability of TEMS to take part and excel in lawmaking that is innovative and responsive to business needs has not been furthered by the 'legislative tornado' imposed on them by the mandate to comply with the AC.

STATE OWNERSHIP UNDER THE AC

Despite the fact that the European Community has been firmly committed to the creation of a common market and thus implicitly to a market based

[81] Case C-208/00 *Ueberseering BV v Nordic Construction Company Baumanagement GmbH* [2002] ECR I-09919.
[82] Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd*. This judgment of 30 September 2003 is not yet published in ECR, but is available at <http://curia.eu.int> (5 March 2004).
[83] What the likely benefits of competition for incorporation are, is another matter. As Kahan and Kamar suggest, above n 78, only Delaware benefits from franchise taxes in a tangible manner.

economy, the EC Treaties did not commit Member States to a particular ownership form, ie to private ownership. Article 295 TEU states explicitly that the Treaty 'does not prejudice the rules in Member States governing the system of property ownership.' Maintaining a large private sector or privatising state owned enterprises was therefore never a pre-condition for membership in the EU (provided, of course, that state ownership would not stand in the way of a functioning market economy). The scope of the Treaty's neutrality concerning ownership has, however, been recently put to a series of tests. The European Court of Justice argued in three parallel rulings in June 2002 that golden shares held by the state in privatised companies would be subjected to review under provisions of the Treaty that commit members to the free movement of capital (Article 56 TEU).[84] In two of the three cases, the ECJ declared that golden shares held by the state in privatised companies were in fact in violation of the free movement of capital. The decisions concerned actions brought by the Commission against three Member States: Belgium, France, and Portugal.[85] The Portuguese case was the most straightforward of the three, as the relevant law stated that the state could exercise veto rights against foreigners acquiring a substantial stake in the privatised companies. This smelled of discrimination against foreign capital, which was in clear violation of Treaty provisions unless there was a compelling public interest. The French law did not include an explicit provision against foreign ownership, but resembled in other ways the Portuguese law. Under the French law, any acquisition of shares in the privatised company had to be approved by the relevant Ministry. The law did not stipulate under what conditions approval would be granted or denied, and did not establish explicit procedures for review of ministerial decisions. It was thus left to the discretion of the Ministry to either approve or deny the acquisition of shares. The French government defended its law by arguing that it did not discriminate between French and foreign acquirers of shares and therefore did not violate the principle of the free movement of capital. Moreover, Article 58 (1) (b) allows governments to restrict the fundamental freedom of capital on public policy grounds. The relevant company in which the state held a golden share was Elf Acquitaine, the oil company. The government argued that securing sufficient oil supply in times of crisis justified these restrictions. The ECJ acknowledged in principle that protecting a Member State's oil supply may indeed be a public policy ground to restrict the free movement of capital. The court emphasised, however, that the measures taken must be proportionate, ie that they must be effective

[84] P Camara, 'The End of the "Golden Age" of Privatisations? The Recent ECJ Decisions on Golden Shares' (2002) 3 *European Business Organization Law Review* 503.
[85] Case C-367/98 *Commission of the European Communities v Portuguese Republic* [2002] ECR I-04731; Case C-483/99 *Commission v France* [2002] ECR I-04781; Case C-503/99 *Commission v Kingdom of Belgium* [2002] ECR I-04809.

and proportionate to the kind of threat that is envisaged. In the French case, the court argued that the broad discretion granted to the Ministry without any guidance for investors about the conditions for approval or denial was not proportionate and therefore in violation of the free movement of capital.

By contrast, the ECJ accepted the Belgian variant of veto rights regarding the acquisition of shares in the relevant companies, in this case the major gas and electricity companies of the country. Unlike the French solution, Belgium did not require approval, but just notification of the ministry. Once notified, the ministry could take actions to halt the transaction, but any such action taken had to be explained in detail to the parties concerned. Even though the law did not specify under what conditions the state would exercise its veto right, the fact that detailed reasoning was required by law and that action had to be taken by the state to veto, instead of giving the ministry a flat approval right as in the French case, made this measure 'proportionate' to the potential threat.

These three decisions were only the beginning of an attack by the Commission on Member States' use of extensive control rights in partially private firms. Two additional golden share decisions were handed down in May 2003 against Spain and the UK.[86] In both cases, the court affirmed its previous golden shares rulings, the stark critique by the General Advocate who invoked Article 295 TEU notwithstanding. In addition, the Commission has initiated actions against the German 'lex Volkswagen', which ensures the state of lower Saxony in Germany a veto right against the transfer of control in the car company.[87]

These ECJ decisions hold important lessons for the new Member States. They create the possibility that not only golden shares, but other measures taken by governments in only partially privatised firms, may be measured against the core principles embedded in the Treaty. Governments will be forced to choose to either retain full ownership of firms or have their control rights over partially privatised firms subjected to greater scrutiny. On the positive side, the ECJ rulings are likely to enhance the transparency of government actions with regard to companies they still control directly or indirectly. This is a welcome trend in TEMS where, despite strong commitments to privatisation and market economies, governments have not always refrained from the temptation to use control rights they have retained to pursue industrial policies. As the ECJ decision on the Belgium case suggests, control rights are not prohibited per se, but they must be proportionate to the threat posed. On the negative side, the decisions may create disincentives

[86] Case C-463/00 *Commission v Kingdom of Spain* [2003] ECR I-04581 and Case C-98/01 *Commission v United Kingdom* [2003] ECR I-04641.
[87] See European Commission *Free Movement of Capital: European Commission asks Germany to justify its Volkswagen law* — European Commission Press Release IP 03/410 (19 March 2003).

to privatise in the first place. However, given the scope of privatisation that has already been accomplished in the TEMS, this danger seems less serious at this point in time. Even if this was different, there is an inherent logic to the ECJ decisions. Governments that want to obtain the benefits from privatisation, ie immediate revenue in form of the purchase price and relief from potential future liabilities, must commit to allow the market to run its course, unless they have good reasons to intervene. If they cannot or do not want to make this commitment, they should also bear the full costs of ownership.

What is to be noted, however, is that the positive impact EU membership may have on (partial) state ownership is the result of actions taken by the Commission and ECJ rulings, not standards agreed upon by the Member States. In fact, some of the ECJ's case law may be said to over-rule the implicit agreement by Member States that market integration would be conditional on mutual agreement among them on core issues, such as their choice over property regime.

INSTITUTIONAL GOVERNANCE UNDER THE AC

Institutional governance is an integral part of corporate governance. The allocation of rights and responsibilities to different stakeholders is typically not sufficient to ensure that these rights will be enforced. Coasian bargaining assumes a utopian world without transaction costs, but even financial markets do not come close to such a world, certainly not financial markets in the post-socialist countries.[88] The most commonly known institutional governance mechanisms in this area are courts and regulators. A little over 10 years ago, financial market regulators did not exist in TEMS, and courts were in the middle of lustration proceedings, scrambling to come to terms with their past under the socialist system, and trying to redefine themselves as independent agents for the rule of law with the competence to handle complex commercial matters. Not surprisingly, these institutions are still perceived to be rather weak, although there is substantial variation across countries, as discussed above.

For companies trying to hide assets from investors and in the business of circumventing investor protection law, weak governance institutions are attractive. Such institutions will not pose a challenge to their business practices. By contrast, for companies hoping to attract investors and in need of raising outside capital, weak governance institutions are a great disadvantage. While such companies may adopt voluntary governance codes and commit in words to respecting investor rights, the words of new entrants to

[88] S Johnson, E Glaeser et al, 'Coase vs Coasians', above n 32.

the market do not carry much weight, as they have little reputation to lose. Moreover, these new entrants come from an environment where investor rights were violated quite frequently. Weak governance institutions thus exacerbate the signaling problem these companies face.[89]

One strategy to help these companies is to strengthen local governance institutions. A strong argument has been made for ensuring good local institutions even in a world of integrated financial markets. As Fox argues, the real beneficiaries of effective domestic institutions are stakeholders who are relatively immobile, such as employees, or the communities where companies are located.[90] Investors can diversify their risk, but other stakeholders of the firm and the domestic economy will suffer from the lack of effective investor protection. It should therefore be in the interest of local policy makers to ensure that sufficient protections are in place to enhance future growth and productivity of domestic companies. This argument is supported by recent empirical data, which suggest that even when companies migrate to other markets the quality of investor protection in their home jurisdiction has a positive impact on their share performance.[91] Improving domestic institutions is therefore a primary task for TEMS.

The accession agreements with TEMS stress the importance of legal institutions, including courts and regulators and explicitly reject legal reforms that are focused exclusively on the law on the books. Judicial reform has been an accession condition and progress has been monitored by the EU. This may have contributed to the gradual strengthening of these institutions in TEMS. By contrast, the relevant directives on company law and financial market regulations do not contribute much to the strengthening of governance institutions. In most instances they only require Member States to establish a regulator endowed with sufficient power to enforce the directive in question, leaving the choice of enforcement devices (civil liability, criminal or administrative sanctions, etc) to the Member States. The new Market Abuse Directive for the first time spells out that Member States should employ not only criminal, but also administrative sanctions, in order to enforce the directive.[92] The rest is left to the Member States and their ability and willingness to endow regulators with the necessary resources and powers to fulfill this task.

The fragmentation of, and differences in the capacity and quality of, law enforcement has been recognised as a key problem in the harmonisation of

[89] Nonetheless, some companies have been able to overcome this problem. See L Klapper and I Love, above n 33.
[90] Fox, above n 35.
[91] S Claessens, D Klingebiel *et al*, 'The Future of Stock Exchanges: Determinants and Prospects' (2002) 3 *European Business Organization Law Review* 2: 403.
[92] See Art 14 of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJ L096/16.

financial market regulations by the Lamfalussy Report,[93] which reviewed the EU's achievement in financial market regulation. Variations in the effectiveness of law enforcement is of concern especially in the area of financial market regulation, where mutual recognition is the guiding parameter. While Member States have refuted the idea of mutual recognition in the area of corporate law, in the area of financial market regulation a combination of minimum standard harmonisation and mutual recognition has been pursued. Thus, a company that has issued shares in one Member State may use the same documentation to issue shares in a different Member State. Compliance with the standards established by the EU and adopted in the home country thus provides companies with a 'European passport.' In theory, the passport could be issued by any Member State, irrespective of the origin of the company. In practice, however, EU regulations have allocated regulatory responsibility to the company's home Member State.[94] To ensure effective monitoring and law enforcement, the directive calls upon Member States to ensure that competent authorities of different Member States cooperate with each other and exchange information for that purpose.[95]

This approach has drawn substantial critique from the financial community, because it does not pay tribute to the reality of financial market integration and leaves many companies without effective regulation. A company from a TEMS, for example, that wishes to issue and trade securities exclusively on the London Stock Exchange, will remain under the regulatory authority of its home jurisdiction, rather than the British Financial Services Authority. This allocation of regulatory authority may prove disadvantageous for companies from TEMS, where enforcement institutions are weak and reforms are only slowly taking hold. They simply cannot opt out of a weak regulatory environment by listing elsewhere in the EU. If they want to use cross-listing as a commitment device, cross-listing within the EU won't do — ie they may not accomplish this by staying in Europe. This may increase their incentives to migrate across the Atlantic.

In sum, the governance structure established by current and future EU directives on financial market regulations is one that is based on home country regulation combined with coordination among regulators of different Member States where a company may issue and/or trade its shares. Companies from TEMS are thus 'locked in' with their current regulators. This may induce these companies to lobby for more effective regulation should they deem this advisable — and this may ultimately benefit other

[93] A Lamfalussy, *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets* (Brussels, European Union, 2001).
[94] See Art 13 of Prospectus Directive, above 60.
[95] See Art 22 of Prospectus Directive, *ibid*.

constituencies in their home jurisdiction — but this process will take time. In the meantime, companies must find other ways to escape the trap of weak institutional governance in their home jurisdiction.

CONCLUDING OBSERVATIONS

The AC required TEMS to adapt their existing legislation to incorporate directives aimed at harmonising aspects of company law and financial market regulations. The impact of the legislative changes mandated by the AC have been described as a 'legislative tornado.' TEMS passed these laws by the meter, often copying laws wholesale from current EU Member States to avoid costly adaptations. Compliance with the AC thus imposed substantial costs on TEMS. This chapter has asked to what extent the AC actually benefits TEMS, in particular whether it helps resolve some of the basic corporate governance issues these countries face today. The analysis suggests that the benefits are ambiguous. Only a few of the directives directly address the major corporate governance issues TEMS face today. Many harmonisation requirements have been recognised by current Member States as outdated and not furthering the ultimate purpose of company law to enable a competitive process among companies from different Member States. A series of reports on modernising European company law and revamping the structure and process of issuing financial market regulations in the European Union has been launched over the last few years. These reports have already triggered new proposals for directives, which will need to be transposed into national law by Member States, including the TEMS. From their perspective, this means that even before any of the previous laws and regulations have been tested in practice, they will be changed once again. Legal change for the better is certainly desirable. But frequent legal change has its own costs as it creates substantial legal uncertainties. This is not to say that companies from TEMS will not benefit from their home countries joining the EU. However, the main benefits arise from the ECJ's interpretation of the Treaty provisions, not the harmonisation as embodied in the AC.

References

Aoki, M and Kim, H K (1995) *Corporate Governance in Transitional Economies* in E D Institute (ed), *EDI Development Studies* (Washington, DC, The World Bank).

Baums, T (1999) 'Corporate Contracting Around Defective Regulations' 155 *Journal of Theoretical and Institutional Economics* 119.

Bebchuk, L and Hart, O (2002) 'A Threat to Dual-Class Shares' *Financial Times* (London, UK, 31 May).

Becht, M, Bolton, P, and Roell, A (2002) 'Corporate Governance and Control' *European Corporate Governance Institute* (ECGI Working Paper Series in Finance no 2).

Becht, M and Roell, A (1999) 'Blockholdings in Europe: An International Comparison' 43 (4–6) *European Economic Review* 1049.

Berglöf, E and Pajuste, A (2003) 'Emerging Owners, Eclipsing Markets?' in P Cornelius and B Kogut (eds), *Corporate Governance and Capital Flows in a Global Economy* (Oxford, Oxford University Press).

Berglöf, E and von Thadden, E L (1999) 'The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries' *Proceedings of the Annual Bank Conference on Development Economics* (Washington, The World Bank).

Berle, A A and Means, G (1932) *The Modern Corporation and Private Property* (New York, Columbia University Press).

Black, B and Kraakman, R (1996) 'A Self-Enforcing Model of Corporate Law' 109 *Harvard Law Review* 1911.

Black, B, Kraakman, R and Tarassova, A (2000) 'Russian Privatisation and Corporate Governance: What Went Wrong?' 52 *Stanford Law Review* 1731.

Boone, P and Rodionov, D (2001) 'Rentseeking Russian Style' (Unpublished manuscript).

Camara, P (2002) 'The End of the "Golden Age" of Privatisations? The Recent ECJ Decisions on Golden Shares' 3 (2) *European Business Organization Law Review* 503.

Choi, S J and Guzman, A T (1998) 'Portable Reciprocity: Rethinking the International Reach of Securities Regulations' 71 *South California Law Review* 903.

Claessens, S, Klingebiel, D and Schmukler, S (2002) 'The Future of Stock Exchanges: Determinants and Prospects' 3 (2) *European Business Organization Law Review* 403–38.

Coffee, J (1999) 'Privatisation and Corporate Governance: The Lessons from Securities Market Failure' 25 *Journal of Corporation Law* 1.

—— (2002) 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' 111 (1) *Yale Law Journal* 1.

—— (2002) 'Racing Towards the Top? The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance' 102 (7) *Columbia Law Review* 1757.

Daines, R (2001) 'Does Delaware Law Improve Firm Value?' 62 (3) *Journal of Financial Economics* 525.

—— (2002) 'The Incorporation Choices of IPO Firms' *NYU Law Review* 77 (6): 1559.

Dombey, D (2003) 'European parliament backs takeover directive compromise', *Financial Times* (London, UK, 17 December).

European Bank for Reconstruction and Development (1998) through (2003) *Transition Report* (European Bank for Reconstruction and Development London).

Enriques, L (2003) 'Silence is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage' *European Corporate Governance Institute* (ECGI Working Paper Series No 7, 2003).

Enriques, L and Macey, J (2001) 'Creditors vs. Capital Formation: The Case Against the European Legal Capital Rules' 86 *Cornell Law Review* 1165.

Fox, MB (1999) 'Retaining Mandatory Securities Disclosure: Why Issuer Choice is not Investor Empowerment' 85 *Virginia Law Review* 1335.

—— (2002) 'US Perspectives on Global Securities Market Disclosure Regulation: A Critical Review' 3 (2) *European Business Organization Review* 337.

Frydman, R, Gray, C, Hessel, M and Rapaczynski, A (1998) 'When Does Privatisation Work?' 114 (4) *Quarterly Journal of Economics 1153*.

Frydman, R, Gray, C and Rapaczynski, A (1996) *Corporate Governance in Central Europe and Russia* Vol 1 and 2 (Budapest, Central European University Press).

Gordon, J (2002) 'An American Perspective on the New German Anti-takeover Law' *European Corporate Governance Institute* (ECGI Working Paper Series).

Hansmann, H (1996) *The Ownership of Enterprise* (Cambridge, Mass, The Belknap Press of Harvard University Press).

Hirschman, A O (1970) *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Cambridge, Mass, Harvard University Press).

Hopt, K J (2002) 'Modern Company and Capital Market Problems - Improving European Corporate Governance after Enron' *European Corporate Governance Institute* (ECGI Working Paper Series 1 no 5).

Johnson, S, Glaeser, E and Shleifer, A (2001) 'Coase vs Coasians' 116 (3) *Quarterly Journal of Economics* 853.

Johnson, S, La Porta, R, Lopez-de-Silanes, F and Shleifer, A (2000) 'Tunneling' 90 (2) *American Economic Review* 22.

Kahan, M and Kamar, E (2002) 'The Myth of State Competition in Corporate Law' *55 Stanford law Review* 679.

Kirchner, C and Painter, R W (2000) 'European Takeover Law: Towards a European Modified Business Judgment Rule for Takeover Law' 1 (2) *European Business Organization Law Review* 353.

Klapper, L and Love, I (2002) 'Corporate Governance, Investor Protection and Performance in Emerging Markets' *World Bank Policy Research* (Working Paper 2818, March).

La Porta, R, Lopez-de-Silanes, F, Shleifer, A and Vishny, R W (1998) 'Law and Finance' 106 (6) *Journal of Political Economy* 1113.

Lamfalussy, A (2001) *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets* (Brussels, European Union).

Megginson, WL, Netter, JM (2001) 'From State to Market: A Survey of Empirical Studies on Privatization' 39 (2) *Journal of Economic Literature* 321.

Mülbert, P, and Birke, M (2000) 'In Defense of Passivity - On the Proper Role of a Target's Management in Response to a Hostile Tender Offer' 1 *European Business Organization Law Review* 445.

—— (2002) 'Legal Capital: Is there a Case Against the European Legal Capital Rules?' 3 (2) *European Business Organization Law Review* 695.

Olsson, M (2001) 'Adopting the acquis communautair in Central and Eastern Europe: A Report on the Transposition and Implementation of the so-called Large Holding Directive (88/627/EEC)' *European Corporate Governance Institute*.

Pistor, K (2001) 'Law as a Determinant for Stock Market Development in Eastern Europe' in P Murrell (ed), *Assessing the Value of Law in Transition Economies* (Ann Arbor, University of Michigan Press).

Pistor, K, Raiser, M and Gelfer, S (2000) 'Law and Finance in Transition Economies' 8 (2) *The Economics of Transition* 325.

Pistor, K, and Turkewitz, J (1996) 'Coping with Hydra: State Ownership After Privatisation' in R Frydman, C Gray, and A Rapaczynski (eds), *Corporate Governance in Central Europe and Russia* (Budapest, Central European University Press).

Pistor, K and Xu, C (2003) 'Fiduciary Duties in (Transitional) Civil Law Jurisdictions - Lessons from the Incompleteness of Law Theory' in C Milhaupt (ed), *Global Markets, Domestic Institutions: Corporate Law and Governance in a New Era of Cross-Border Deals* (New York, Columbia University Press).

Plender, J (2003) 'Continental capitalism à la carte' *Financial Times* (London, UK, 21 February).

Rock, E (2002) 'Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure' 23 *Cardozo Law Review* 675.

Romano, R (1993) *The Genius of American Corporate Law* (Washington, AEI Press).

—— (1998) 'Empowering Investors: A Market Approach to Securities Regulation' 107 *The Yale Law Journal* 2359.

Shleifer, A and Vishny, R W (1997) 'A Survey of Corporate Governance' 2 *The Journal of Finance* LII 737.

Soltyskinski, S (1998) 'Transfer of Legal Systems as Seen by the "Import Countries": A View from Warsaw' in U Drobnig, KJ Hopt, H Kötz and EJ Mestmäcker (eds), *Systemtransformation in Mittel- und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsicherheiten* (Tübingen, Mohr Siebeck).

Winter, R K (1977) 'State Law, Shareholder Protection, and the Theory of the Corporation' 6 *Journal of Legal Studies* 251.
Wymeersch, E (2001) 'Company Law in Europe and European Company Law' *Financial Law Institute* (Working Paper Series, 22 August 2003).
Zingales, L (2000) 'In Search of New Foundations' 55 *Journal of Finance* 1623.

15

Corporate Law and Governance in an Enlarged Europe

A COMMENT BY RICHARD M BUXBAUM

IF ONE OVERALL theme is discernible in the four chapters presented at this session, it would have to be one loosely patterned after Berthold Brecht: 'We all are running after Law, but Law runs on behind.'[1] In the nearly 15 years since the latest version of the Great Transformation began, we relearned — and more than once — what we recurrently know and recurrently forget: in this as in many spheres, Law follows, it does not lead. And perhaps this particular decade and a half has added a new lesson: We face revolutionary facts but can only fashion evolutionary rules. Neither economics nor politics permits the state the use of a drydock; the legal system must be rebuilt plank by plank while the country remains at sea. And it does not do in times of turbulent change for Law to follow economic and political reality too closely. We may actually lose sight of the trajectory of these realities — where they are tending towards. We thereby degrade the ability of the legal regime to fulfill either its regulative or its facilitative functions, especially those necessary to ensure the development of a more-free market economy.[2]

The four chapters also suggest that this comment needs to be placed within the new intra-European perspective created by the pending accession of some of the post-Socialist states. The EU insistence on the *acquis communautaire*, with its wholesale imposition of a host of secondary as well as basic legal rules derived from a mature and less turbulent economic and political system onto a politically and economically more variegated, less stable and more turbulent system, has its costs. For Europe to require this

[1] Die Dreigroschenoper: 'Sie alle laufen nach dem Glück, das Glück läuft hinterher.'

[2] VerLoren van Themaat, 'Die Rechtsangleichung als Integrations instrument' in W Hallstein and H-J Schlochauer (eds), *Zur Integration Europas — FS Ophüls* (Karlsruhe, CF Müller, 1965) 243 at 252: 'What is interesting is that it is just the creation of a free common market with undistorted competition that demands by far the most comprehensive legal harmonisation efforts. Obviously, one is here far removed from the thesis that freedom equals *laisser faire, laisser passer*.' (translation by R Buxbaum).

of the transition economies in the new Member States (TEMS) is akin to requiring someone to purchase a complex, low-slung sports car who has neither a garage capable of servicing it nor a road system on which it can run without bottoming out.[3]

This cost is accompanied by a closely related one. The basis of a new legal regime supporting a new private economic sector — a civil code supporting both the routine enforceability of contract and property rights and their routine use to secure the credit component of such an economy — is overlaid and negatively impacted by an *acquis* largely composed in considerable part, though not exclusively, of a flurry of uncoordinated secondary legal rules of great detail. These rules require an administrative machinery that does not yet exist in the recipient countries; or, if it does exist, it is, unfortunately, the relict of the dysfunctional one inherited from a command economy. This relict gains a possibly dangerous new vitality from the continuing 'rearguard' existence in EU and national law of an extensive regulatory apparatus wrapped around such instruments as the mandatory bid, the elimination of preemptive rights, and the reacquisition of an issuer's own shares that modern and more facilitative company law would do well to do without.[4]

One consequence for law is the attitude encouraged by the governors of colonial Mexico, who would put a subscript on the impossible fiscal legislation their Spanish overlords required them to adopt — '*per respettare pero non cumplé*.' Another consequence is also attitudinal: like the American Law Institute's valiant effort to develop a Code of Corporate Governance, a valiant domestic effort to develop 'normal' law is swamped by a more or less hostile takeover movement.[5] And a third — the one most visible to the Western observers who point out the phenomena of 'tunneling' and rent-seeking with more than a hint of Schadenfreude — is the temporary collapse of these economies into the morass of corruption.

This much I take as the sentiments one can fairly read into the four chapters under discussion; now let me highlight their more specific lessons

[3] R Buxbaum, 'Modernisation, Codification, and Harmonisation: The Influence of the Economic Law of the European Union on Law Reform in the Former Socialist Bloc' in R Buxbaum, G Hertig, A Hirsch, and K Hopt (eds), *European Economic and Business Law* (Berlin, Walter de Gruyter, 1996) 125.

[4] One might also mention, in this connection, the debatable position of the EU Commission that litigation as an enforcement tool should not be favoured. See the comments to Art 4 of the proposed thirteenth Directive stating that 'It is desirable to avoid systematic litigation during takeover bids.' That is too large an issue for discussion here, but its significance, and its contrast with at least US history if not with the trend of current US practice, deserves some attention. See Proposal for a Directive on takeover bids, Brussels 2 October 2002 COM (2002) 534 final, 2002/0240(COD) at 7.

[5] Indeed, this is almost literally the case: As Berglöf points out, the inhibitory impact of the mandatory bid requirement, found in many of these company and capital-market laws, on the presentation of an optimal number of takeover bids is one of the most significant unintended consequences of adopting Western legislation in this fluid and evolving situation.

and in particular comment on how the more economically focused chapters correlate — in an interesting way — with the legal chapters.

One principal focus found in these chapters is the relation between patterns of firm ownership and the development of organised capital (debt and equity) markets to serve the needs of the newly privatised sector. A second is the overriding priority in both the new private and remaining state productive sector of financial transparency, of accounting. A third, recurring to my introductory comments, is that concerning methods of flexible and adaptable methods of law making and interpretation. And a fourth is the more technical set of problems we tend to identify as private international law, ranging from the selection of the legal system governing the internal affairs of a corporation to that governing the regulation of the new capital markets.

Before coming to the findings of Berglöf and Pistor on the changes in ownership structures and patterns, an important preliminary finding is that for several of these national economies the number of firms that can tap organised financial markets is small both in absolute terms and in the relative sense of their share in the private sector's contribution to GDP. The fact that in some of these economies the use of a more or less free voucher system temporarily created widespread public holdings of companies does not change that picture, since that kind of initial public distribution was only a waystation for the resale of these certificates to the builders of controlling blocks of equity. Thus, to take the extreme example, the median market value of Estonian companies was 1,000,000 EUR. It is meaningless to consider such a sector as a source of an organised capital market. In larger economies — eg, that of Poland — it is of course possible for a local capital market to exist. Given EU mandates of freedom of movement for financial services, however, that will be a fragile plant surviving in the shadow of London and Frankfurt. Institutional intermediaries will transfer local surplus savings, both individual and collective, to the deeper and more liquid exchanges; and the largest of the firms in time will follow with listings in those markets.

One possibility remains, and it is indirectly supported by Berglöf's and Pistor's findings about ownership patterns. Much local privatised corporate-form activity has been captured by one dominant blockholder, often a successful survivor of the state-enterprise era. Putting aside the mentioned common case of a large single minority shareholder, often of Western origin, one often surrounding itself with a specific contractual arrangement with the majority owner that promises an illusion of some minimal protection, in the general case only minority holdings in those enterprises can make it into the public float that justifies a securities exchange. This kind of minority holding may become the principal form of local stock-exchange secondary trading activity, which at least would provide some minimal liquidity to local holders of that float. It will not, however, convert those local markets

into the dual-function markets of New York and London — a market for corporate control as well as a market for 'normal' secondary trading. Of course, that limitation, for various reasons, also is the case with Frankfurt, Milano,[6] Paris, and Zürich; in that sense, this development is no cause for surprise or for criticism (except by the most adamant convergionists).

This reflection on the 'pattern of ownership' theme of these two chapters immediately raises and confirms the importance of a second point, made particularly by Pistor: the salience of accounting and thus of financial transparency to the evolution of these economies. But even that needs to be placed in a broader context. From the point of view of capital formation — at least in its initial stages — the ugly side of state socialism is force; that of capitalism, fraud. The combination of the incentive structure inherent in the new system and the obvious absence of well-tested and well-internalised accounting concepts guarantees problems at this stage, problems sufficiently large to threaten the delicate social consensus needed to legitimise the transformational struggle towards a free-enterprise system of production of goods and services.

The overall development of these 15 years is not a surprising story when compared with earlier stages of capitalism in, say, the United States of 1875–1933. The difference is that then the transformation was from a small-scale and largely agrarian private-sector economy to a large-scale and more urbanised form of the same. And from this transformation-legitimacy perspective, two other differences should be noted. First, Populism was a reaction to the excesses of the economic system, not to the system itself.[7] Second, the corrections to those excesses took time to evolve, and were 'sold' to the electorate in a co-opting, not a cram-down, manner. Today, for the new Europeans, a polite version of a cargo-cult illusion is the analogous legitimator, and probably it is one with a much shorter half-life than that which the legitimating forces at work in Great Britain, Germany, and the United States enjoyed in the mentioned circumstances a century earlier.

This comment suggests a further point, though one not central to Berglöf and Pistor's contributions; namely, the potential abuse of the market power of many of the enterprises privatised or in the process of privatisation. The transfer of state monopoly power into private hands remains one of the intractable issues to this day, and the smaller the national economy within

[6] Indeed, the new Italian company law guarantees the continued one-legged nature of its stock exchanges even if their typical public float were to turn larger and approach the borderline of attracting possible takeover interest. See Legislative Decree, January 17, 2003, no 6, amending Chapter V (stock corporations) of Title V of Book V of the Civil Code (G.U., 22 January 2003, no 17). S 2346(VI) thereof, in combination with s 2351(V), permits the creation of a permanent veto-holding class of 'something' (it is hard to call it shares of stock) perfectly positioned to prevent unwanted takeovers.

[7] See the current reconsideration of this issue, for the specific purpose of recasting our views of Corporation Law, in D Tsuk, 'Corporations Without Labor: The Politics of Progressive Corporate Law' (2003) 151 *University of Pennsylvania Law Review* 1861.

which the particular firm and industry are situated the more intractable the issue. The motives of Western as well as Eastern states that had retained golden shares in the course of privatisation were mixed, of course, and control of their market power not necessarily the leading let alone the only one. But the newest jurisprudence of the EU Court of Justice, essentially voiding this type of post-state ownership as a vehicle of public-policy control,[8] has created a legal and policy vacuum that the fragile fledgling antitrust authorities of the new entrants so far are poorly equipped to fill. Indeed, the decision of the EU authorities to devolve the administration of both cartel and monopolisation law to national authorities if anything exacerbates this problem for the new entrants.[9]

If these reflections are even to some degree valid, the interesting question — and the implicit message of the Doralt-Kalss and Soltysinski chapters — is the linkage between substantive law (including regulation) and the theories and practices of legislation as matters both of legal-cultural and historical path dependencies and of technique. Soltysinski's chapter in particular nicely illustrates both points. So far as the question of models and borrowings is concerned, formal continuity in the doctrinal and systemic sense is at least as important as the substantive content, especially when the latter is the kind of modern transactional content that does not reflect much variation from state to state. Of course that is truer for facilitative legislation, such as the company law he describes, than it is for regulatory legislation; and it is truer for the law of the System, in Habermasian terms,[10] than for the law of the Lebenswelt, where historical and cultural particularities are more centrally at stake. Under these circumstances, it is not surprising that much of the past decade's borrowings were from sources that were picked 'by chance or prestige.'[11]

[8] See ECJ decisions against Spain and the UK of 15 May 2003, Cases C-463/00 *Commission of the European Communities v Kingdom of Spain*; and Case C-98/01 *Commission of the European Communities v United Kingdom of Great Britain and Northern Ireland*. Both cases are available at: Recent Case Law of the Court of Justice and the Court of First Instance, The Court of Justice of the European Communities <U>http://www.curia.eu.int/jurisp/cgi-bin/form.pl?lang=en.htm (4 September 2003).

[9] See Council Regulation (EC) 1/2003 of 16 December 2002 on the Implementation of the Rules on Competition Laid Down in Arts 81 and 82 of the Treaty [2003] OJ L1/1, 1, essentially following Commission of the European Communities' White Paper on Modernisation of the Rules Implementing Arts 81 and 82 of the EC Treaty (formerly Arts 85 and 86 of the EC Treaty) [1999] OJ C132/01. It might fairly be argued that this was a decision taken more for purposes of institutional efficiency and cost control than out of respect for any subsidiarity principle. How Art 3 thereof, which permits stricter (than EU) controls of abuse of unilateral market power while prohibiting stricter controls of horizontal and vertical agreement, will play out from the standpoint of improving the performance of the TEMs' antitrust authorities, remains to be seen.

[10] See in particular J Habermas 'Law as Medium and Law as Institution' in G Teubner (ed), *Dilemmas of Law in the Welfare State* (Berlin, Walter de Gruyter, 1985) 203.

[11] G Ajani, 'By Chance and Prestige: Legal Transplants in Russia and Eastern Europe' (1995) 43 *American Journal of Comparative Law* 93.

More interesting, in my view, are considerations of legislative technique in a different sense. Two related matters stand out under this heading. First, there is the question of the learning process of the statutory law: its flexibility and adaptation to the experiences of the beneficiaries and targets of the transplanted law. While none of the countries under discussion here have gone as far as the frankly experimental Chinese legislation of the1980s, their need frequently to amend the received legislation in the light of later experience highlights the adaptation problem and suggests the need to consider forms of legislation more suited to this exigency than the supposedly permanent legislation embodied in traditional codes.

The second related matter concerns the completeness or incompleteness of the newly adopted legislation. Here, of course, the Civilian tradition of the code militates in favour of relatively open-meshed law, a matter Soltysinski in particular approvingly emphasises. It is, however, a tradition that seems to concern Western and especially United States scholars and practitioners who note both the inexperience of new courts and administrators to fill in the blanks and the potential for abuse that discretion brings in its train.[12] This conflict of viewpoints indeed is a dilemma that only time and experience with the implementation of the new statutes can resolve. I do not believe a theoretical analysis of this issue can help at this stage. That is especially the case when one considers that the much-touted distinction between architecturally coherent, self-contained, and especially comprehensive civil codes, holds up less and less in this age of the 'motorised legislator';[13] the number of special legislative enactments in civilian legal systems, whether nominally attached like barnacles to a civil code or even formally separate, belies that distinction.[14] In short, from this perspective a comment made exactly a decade ago about the learning curve implicit in this evolution probably still holds up.[15]

A specific question of adaptation to European norms is posed by Doralt and Kalss: namely, the decision of the Commission to leave much company-law modernisation to the Member States, maintaining minimum disclosure standards more on the side of investment regulation. This means that the *sujet du jour*, corporate governance, is largely left straddling hard

[12] A more general paper by K Pistor and C Xu, 'Incomplete Law' 35 *New York University Journal of International Law and Politics* 931, makes these points.
[13] C Schmitt, 'The Plight of European Jurisprudence' (1990) G Ulmen (tr), 83 *Telos* 35 at 50. The quotation is correct, but its self-serving nature at the time the original German version was published (Carl Schmitt, *Die Lage der europäischen Rechtswissenschaft* (Tübingen,1950)) needs to be noted — see B Rüthers, *Carl Schmitt im Dritten Reich: Wissenschaft als Zeitgeist-Verstärkung?* (Munich, C H Beck, 1989) at 87.
[14] R Buxbaum, 'The *Sobranie*: A Postscript' in R Buxbaum and K Hendley (eds), *The Soviet Sobranie of Laws* (Berkeley, Research Series University of California at Berkeley, 1991) 211, 218.
[15] J Kranjc, 'Probleme der Übernahme ausländischer Rechtssätze in nationale Rechtssysteme' (1993) 2 *Wirtschaft und Recht in Osteuropa* 409 at 412: 'It is still too early to evaluate the practical implications of this change.'

national law and soft norms, though in the shadow of the EU's minimum standards as to specific points. The authors analyse this choice, and especially its consequences for national legislation, in a sophisticated fashion; but occasionally explicitly, though more often implicitly, they assume and prescribe a contractual rather than a (partially) regulatory model for that new national legislation. On the whole I agree with this policy prescription, but for the present it does present these regimes with a dilemma. The nature of intra-corporate problems in the TEMs so far has been about fairly crude overreaching and opaque behaviour, behaviour that private litigation will have to be primarily responsible to regulate. This in turn means that the capacity of the national courts to handle shareholder disputes with the professional sophistication that this policy requires will be increasingly tested, a situation in which the EU authorities' downplaying of litigation is not helpful.

This leads to the fourth and last comment; namely, whether we should revisit some older notions of harmonising different national approaches to this borderland of corporate governance, with its blurred borderlines marked both by facilitative crossing points and by regulatory watchtowers. I refer, of course, to the renewed interest in private international law — or, since 'private' is a point of contention — to the international conflict of laws that regionalisation and globalisation tendencies in business and finance have provoked. The mixture of methodological and policy questions produced by these tendencies is spawning thoughtful analysis by conflicts scholars.[16] That analysis could be fruitfully extended by a reconsideration of the problem of the internal affairs rule of the corporate conflict of laws. It has a central relevance, as a help or a hindrance, to the achievement of a harmonised set of substantive laws that meet the injunction, particularly relevant to corporation law, of 'as much subsidiarity as possible; as much regulation as necessary.' While most of the paper expended on *Centros*,[17] *Überseering* and *Inspire Art*[18] has come from German beechwood forests, these are indeed cases that legitimately invite and encourage a wider range of national evaluations of the value of reworking this classic field. With these recent cases, the European Court of Justice has wrought something that the US Supreme Court did not (yet?) achieve; namely, the embedding of the internal affairs conflicts doctrine in the EC constitution via the Establishment Clause. It did so, paradoxically, because the still evolving

[16] In lieu of others, both because of its range and its currency, see the paper by H Muir Watt, 'Cyberage Conflicts of Law: Yahoo! Cyber-Collision of Cultures: who regulates?' in (2003) 24 *Michigan Journal of International Law* 673.

[17] Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459.

[18] Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH* [2002] ECR I-09919. See now also Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd*. This judgment of 30 September 2003 is not yet published in ECR, but is available at <U>http://curia.eu.int> (5 March 2004).

Common Market is more fragile and more contested on redistributive grounds than is the more robust American version. There is a lesson in that comparison, one strikingly similar to that propounded by the shock therapists of the early 1990s. The newest and most vulnerable addressees of that lesson are the transforming economies of the states seeking accession. The lesson may be contrasted with that of the current round of more institutionally oriented therapists: efficiency is not a right, only a necessity — and not the only necessity.

References

Ajani, G (1995) 'By Chance and Prestige: Legal Transplants in Russia and Eastern Europe' 43 *American Journal of Comparative Law* 93.

Buxbaum, R (1996) 'Modernisation, Codification, and Harmonisation: The Influence of the Economic Law of the European Union on Law Reform in the Former Socialist Bloc' in R Buxbaum, G Hertig, A Hirsch, and K Hopt (eds), *European Economic and Business Law: Legal and Economic Analysis on Integration and Harmonization* (Berlin,Walter de Gruyter).

Buxbaum, R (1991) 'The *Sobranie*: A Postscript' in R Buxbaum and K Hendley (eds), *The Soviet Sobranie of Laws* (Berkeley, University of California).

Habermas, J (1985) 'Law as Medium and Law as Institution' in G Teubner (ed), *Dilemmas of Law in the Welfare State* (Berlin, Walter de Gruyter).

Kranjc, J (1993) 'Probleme der Übernahme ausländischer Rechtssätze in nationale Rechtssysteme' 2 *Wirtschaft und Recht in Osteuropea* 409.

Muir-Watt, H (2003) 'Cyberage Conflicts of Law: Yahoo! Cyber-Collision of Cultures: Who Regulates?' 24 *Michigan Journal of International Law* 673.

Pistor, K and Xu, C (2003) 'Incomplete Law' *New York University Journal of International Law and Politics* (forthcoming, copy with author).

Rüthers, B, and Schmitt, C (1989) *im Dritten Reich: Wissenschaft als Zeitgeist-Verstärkung?* (Munich, CH Beck).

Schmitt, C (1950) *Die Lage der europäischen Rechtswissenschaft* (Tubingen, Internationaler Universitätsverlag).

Schmitt, C (1990) 'The Plight of European Jurisprudence' 83 *Telos* 35.

Tsuk, D (2003) 'Corporations Without Labor: The Politics of Progressive Corporate Law' 151 *University of Pennsylvania Law Review* 1861.

Van Themaat, V (1965) 'Die Rechtsangleichung als Integrations instrument' in W Hallstein & H-J Schlochauer (eds), *Zur Integration Europeas — FS Ophüls* (Karlsruhe, CF Müller).

16

Corporate and Securities Law Conditions in the Acquis Communautaire: *A Comment on Pistor and Berglöf and Pajuste*

MERRITT B FOX

AS PART OF the *acquis communitaire* (AC), the European Community has formulated corporate governance reforms to be imposed on the future Eastern European transition economy Member States (TEMs). The contributions in this volume by Katharina Pistor[1] and Eric Berglöf and Anete Pajuste[2] each raise serious issues relating to the conditions being imposed. Their contributions suggest three matters worthy of further reflection: What criteria should be used to determine whether the conditions for EU membership should include adoption of a regulation mandating any particular apparently beneficial rule of corporate behaviour? How do the regulations undertaken by the TEMs in preparation for membership fare according to these criteria? Finally, more generally, what has been gained intellectually from the process of developing and critiquing the conditions that are being imposed on the TEMs?

APPROPRIATE CRITERIA FOR DETERMINING WHAT CORPORATE AND SECURITIES LAWS SHOULD BE IMPOSED ON THE TEMS

Suppose that as a scholar or policy maker, one has gone through an honest exercise of considering what would be the ideal corporate and securities rules for firms in the TEMs to follow. It does not automatically follow that one should favour requiring the TEMs to adopt regulations mandating that

[1] K Pistor, chapter 14.
[2] E Berglöf and A Pajuste, chapter 13.

their firms conform with each of these apparently optimal rules. There is some possibility that despite one's good faith best analysis, one's prescription is wrong. Before making the decision to favour requiring the TEMs to adopt such a regulation, three enquiries are in order.

Is it Necessary to Make the Rule Mandatory?

The first question to ask is whether a regulation *mandating* an apparently optimal rule is even desirable. Is there some kind of market failure such that individual firms in the TEMs will not, or because of a deficient system of contractual enforcement will not be able to, bind themselves on their own to follow the rule through devices such as provisions in their charters or registering their shares on a stock exchange? Unless there is failure of this sort, if the rule truly is efficient, firms in the TEMs can be expected ultimately to adopt the rule on their own. The suggestion that this be the initial question is not meant to imply that such failures do not exist, or even, given the problems of contractual enforcement in the TEMs, that such failures are not widespread.[3] Rather, it is to point out that the possibility of error in one's assessment of what is on average optimal for firms in the TEMs argues against having mandatory rules where such a failure does not exist or does not appear to be serious. So does the fact that the needs of any individual firm in any particular TEM may deviate significantly from what would be optimal for the average firm.

Are there Sufficient Spillover Effects to Justify EU Conditions?

Assume that there is a sufficiently great market failure to justify a regulation mandating an apparently optimal rule. The next question is whether there are sufficient spillover effects into other countries that the matter is better dealt with at the Community level than left to the discretion of each individual TEM. Unless there are, conditioning entry on adoption of such a regulation would rarely be justified. This is because the possibility of error in one's assessment of what is on average optimal for firms across all the TEMs and differences among the TEMs in the needs of their particular firms argue in favour of each individual TEM deciding whether such a regulation is desirable and, if so, how it should be designed. The individual TEM is closer to the problem and, absent substantial spillover effects, has

[3] Whether a failure in contractual enforcement justifies a regulation mandating the rule depends on whether that failure is relatively greater than any expected failure in private or public enforcement of the regulation due to inadequate resources or political pressures.

an incentive to make the globally optimal decisions since doing so will also maximise the economic welfare of its own citizens.

Answering whether there are sufficient spillover effects to justify a Community level decision requires some careful economic analysis. For example, one might think on first impression that when poor corporate governance results in lower payoffs to current EU member country investors in TEMs' firms, there is a spillover effect. This is not the case, however, if the price the member country investors paid for their shares was already discounted to reflect the expectation of low payoffs from poor corporate governance. Then the effects of making a bad regulation are concentrated at home. As a general matter, in the initial years of a TEM's Community membership, the period before economic integration with the rest of the Community will have gained substantial traction, spillovers from bad corporate and securities law will probably be concentrated primarily at home.[4] As the level of trade between the TEM and other Community members grows and the mobility of other factors of production besides capital increase, the spillovers will become greater.[5] Thus the conclusion is not that there is no role for Community based directives eventually applying to the TEMs, particularly as integration continues to deepen, but that the case for doing so is weakest in the early years of membership.

Is a Condition Necessary to Help the TEMs Help Themselves?

Again, assume that there is a sufficiently great market failure to justify a regulation mandating an apparently optimal rule. I argue above that conditioning membership on adoption of such a regulation is still unjustified unless there are sufficient spillover effects. The premise of this argument is that the individual TEM is closer to the problem and, absent substantial spillover effects, has an incentive to make the globally optimal decision since doing so will maximise the economic welfare of its citizens. It is of course possible that the government of the TEM will not make the regulatory decision that maximises the welfare of its citizens. If so, conditioning membership on adoption of the rule might be appropriate even without spillover effects. The grounds would be that doing so helps the TEM help itself. Considerable caution, however, needs to be employed before using this rationale to conclude that the TEMs should be required to adopt a regulation adopting what appears to be an optimal rule. One must be highly confident both that the apparently optimal rule really is optimal and that the

[4] MB Fox, 'Securities Disclosure in a Globalizing Market: Who Should Regulate Whom' (1997) 95 *Michigan Law Review* 2498, 2561–9.
[5] *Ibid.*

political systems within the TEMs are sufficiently defective that they will fail to adopt such obviously desirable regulations.

APPLYING THE CRITERIA TO THE AC

The AC requires that the TEMs have corporate laws and financial market regulation that is in accord with existing EU law.[6] Let us consider, therefore, the discussions of Pistor and Berglöf and Pajuste, concerning this requirement in light of the criteria set out above.

Pistor finds that in many areas, EU corporate and securities law is simply ineffective, stating that 'EU community law has not produced a coherent legal framework for internal governance.'[7] Moreover, while the EU does have a coherent, directives based, framework relating to disclosure, Member State enforcement has been lax.[8] As a consequence, the disclosure laws the members put on their books in accordance with these directives often have little actual bite. Pistor points out as well that the 2nd Council Directive mandating Member State statutes requiring a supermajority shareholder vote to reduce a corporation's legal capital is largely irrelevant since most corporations retain far more in retained earnings than their minimum legal capital.[9] In these areas — a general internal governance framework, disclosure and minimum capital requirements — the AC cannot be accused of imposing the wrong conditions upon the TEMs. For good or for bad, the AC is imposing no effective conditions at all.

As for the desirability of the only specific internal governance provision that Pistor finds might have some effectiveness, the requirement of preemptive rights that can only be waived by a supermajority shareholder vote, commentators are split, with some finding it an important minority shareholder protection device and others finding it a rule that primarily benefits block holders.[10] The discussion above suggests that this lack of consensus signals the undesirability of conditioning membership on adoption of a regulation mandating no waiver of preemptive rights absent supermajority vote. This is particularly the case given that there is no obvious market failure that would prevent firms in the TEMs from adopting such a rule on their own if it were efficient. Moreover, there is a lack of any obvious spi-llover effects if a TEM on its own makes the wrong decision concerning whether to adopt such a regulation mandating the rule.

[6] Pistor, above n 1.
[7] *Ibid.*
[8] *Ibid.*
[9] *Ibid.*
[10] *Ibid.*

Berglöf and Pajuste focus primarily on the spread through Europe, including in a number of TEMs, of mandatory bid regulations. They consider the implications of the spread of these rules in light of the increasingly concentrated pattern of share ownership in the TEMs, which they carefully document. A mandatory bid rule requires any person acquiring a control block of a corporation's shares to offer to buy the remaining outstanding shares on the same terms. Berglöf and Pajuste maintain that such rules are poorly suited to the corporate governance problems facing the TEMs because they make changes of control too expensive. This is unfortunate, they maintain, because it is often impossible for needed restructuring to go forward without a change in control.[11] Berglöf and Pajuste have a valid point here. The incumbents currently in control of too many TEMs corporations are still the same persons who controlled the pre-privatisation state owned versions of these enterprises.[12] These managers can be substantial obstacles to much needed restructuring.

There are countervailing considerations, however, that make a mandatory bid rule not an unalloyed evil for a TEM. In contrast to the need for control changes to allow restructuring, there are other characteristics of the TEMs that make their firms particularly well suited to a mandatory bid rule. The underlying assumption of a mandatory bid rule is that for a large portion of potential purchasers of a controlling block, their willingness to pay a premium is because they plan to use the control so acquired to give themselves a greater than pro rata share of the wealth generated by the corporation. In such a case, the premium the potential acquiror is willing to pay for the control block reflects the amount of wealth that he expects to be able to divert from the non-control shareholders, not gains from imposing better management. A mandatory bid rule, by forcing the potential acquiror to pay the same premium for each non-control share as he pays for the shares in the control block, makes uneconomical an acquisition based simply on the expectation of wealth diversion.[13] The weaker a country's legal protections against such diversions, the larger the portion of potential acquirors of control are so motivated. Because legal protections against diversions are particularly weak in the TEMs, the mandatory bid rule's screen against such acquisitions is more valuable than in countries with greater protections.

Suppose, as Berglöf and Pajuste recommend, a TEM decides not to adopt a mandatory bid rule, in order to promote restructuring. Are there any efficiency

[11] Berglöf and Pajuste, above n 2.
[12] *Ibid*.
[13] This position has been best articulated in the legal literature in WD Andrews, 'The Stockholders' Right to Equal Opportunity in the Sale of Shares' (1965) 78 *Harvard Law Review* 505, 515–22. A reply articulates a position similar to Berglöf and Pajuste: see GB Jarvas, 'Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews' (1966) 32 *University of Chicago Law Review* 420, 425–7.

losses that might undermine or even overwhelm the efficiency gains of easier restructuring? At first glance, it might appear not. As long as the wealth diversion motivated control acquisitions relate to currently existing shares, the higher level of these acquisitions that will occur in the absence of a mandatory bid rule will not, in and of itself, necessarily involve any loss of efficiency, just wealth transfers. But in a country with no mandatory bid rule, the prospect that such wealth diverting control acquisitions will be allowed to occur in the future at this higher level makes it very difficult for its firms to offer new issues of shares at a price high enough to justify the dilution involved. This difficulty may involve significant efficiency losses since the general unavailability of bank financing leaves most firms in the TEMs reliant on retained earnings and foreign direct investment as their sole means of financing.[14] The lost new share issues would have had the potential for funding positive net present value projects that otherwise go unfunded for lack of a means of financing.[15]

Given these competing considerations that make a definitive determination of the desirability of a mandatory bid rule difficult, it would not be appropriate to condition community membership on adoption of a regulation imposing, or for that matter prohibiting, mandatory bid rules on all TEMs firms. Uncertainty as to their desirability for the TEMs, the lack of a showing of a market failure justifying that such rules be mandatory, and the lack of any showing of real spillover effects, all argue against requiring TEMS to adopt a rigorous mandatory bid rule. While earlier it appeared that the AC would require the adoption of a regulation imposing a rigorous mandatory bid rule, fortunately this ultimately has not turned out to be the case. The recently adopted 13th Directive on takeover bids does require member states to adopt a mandatory bid rule, but it leaves it to the Member States to determine the relevant threshold.[16] Thus a Member State could, to give an extreme example, arguably define the acquisition of anything less than a 99 per cent shareholding not to be the acquisition of a control block. This discretion gives member states sufficient flexibility to avoid any negative impact of the mandatory rule. Moreover, as Berglöf and Pajuste emphasise, the rules are in any event interpreted in several TEMs in a 'very lax' fashion.[17]

[14] Berglöf and Pajuste, above n 2.
[15] Berglöf and Pajuste tend to dismiss the importance of designing legal institutions supportive of public share ownership on the grounds that so little public offering of securities is going on now, ibid. In my view, this is too static an approach. Given the potential efficiency gains from an increase in such offerings, the design of legal institutions today should give due weight to whether they help or hinder promotion of this form of financing.
[16] See Art 5 of the proposed 13th Directive on takeover bids, COM (2002) 534 final, Brussels 2 Otober 2002, 2002/0240 (COD). The takeover directive was approved by the European Parliament in December 2003. For details, see Pistor chapter 14.
[17] *Ibid*.

INTELLECTUAL GAINS FROM THE PROCESS OF DEVELOPING AND CRITIQUING THE CONDITIONS

The foregoing discussion suggests that the corporate and securities law conditions imposed by the AC do not have a very serious impact on the TEMs. This might suggest that the effort that went into developing and critiquing these conditions was largely wasted, but I do not think so. Forcing policy makers and scholars to think about corporate governance in the context of enlargement leads to the same kind of more generalised enlightenment that thinking about transition economics does. Studying what is needed to get a market economy up and running where there has not been one before has led to a better understanding of how markets work more generally. The resulting learning is useful not just for transition economies but for highly developed market economies as well. The same is true of corporate governance. Before we had to confront the challenge of transition, our understanding of how market economies work and our understanding of good corporate governance each underestimated the importance of certain legal institutions. This failure of understanding appears to be the result of the fact that these institutions, while not always ideally configured, were so pervasive in developed capitalist economies that they were taken for granted. When viewed through the lens of the transition experience, the function of these institutions is better understood and their optimal design more easily perceived. For example, we understand much better now the efficiency benefits arising from courts that are capable of sophisticated application of the law to particular cases and from effective enforcement of the resulting judgments.

Asking what corporate governance provisions the TEMs should adopt should be helpful to the current EU members to think about what is really important for themselves as well. This is particularly true since, as both contributions note, the TEMs display several characteristics — block holder control, governmental share ownership in major publicly traded corporations, and relatively weak enforcement of corporate and securities laws — that are shared with most current Community members outside of the United Kingdom. These characteristics set both the TEMs and most current Community members apart from the Anglo-American situation that is the basis of the most fully articulated models of corporate governance. So asking what is good for the TEMs is often the same as asking what is good for most other Community members as well.

The intellectual effort that has been involved in the debate over the appropriate corporate governance conditions for entry of the TEMs to Community membership can thus be expected to have the same 'boomerang effect' that has been noted with respect to new member conditions in other

areas by Professor Wojciech Sadurski.[18] This is all the more so because, as noted above, the AC requires that the TEMs have corporate laws and financial market regulation that is in accord with existing EU law.[19] Consequently, the critiques by Pistor and by Berglöf and Pajuste of corporate and securities law conditions imposed by the AC on the TEMs should apply as well to the EU corporate and securities law framework relating to the existing Community members. This fact makes these interesting and provocative articles have even broader import than their titles purport.

References

Andrews, W D (1965) 'The Stockholders' Right to Equal Opportunity in the Sale of Shares' 78 *Harvard Law Review* 505.

Fox, M (1997) 'Securities Disclosure in a Globalizing Market: Who Should Regulate Whom' 95 *Michigan Law Review* 2498.

Jarvas, G B (1966) 'Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews' 32 *University of Chicago Law Review* 420.

[18] Oral remarks of Professor Wojciech Sadurski at the Law and Governance in an Enlarged Europe Conference, Columbia Law School (4 April 2003).
[19] Pistor, above n 1.

Part IV

Domestic Institution Building in the Shadow of the *Acquis*

17

Implementation and Compliance: Stimulus for New Governance Structures in the Accession Countries

ROLAND BIEBER AND MICAELA VAERINI

THE EVOLVING CONCEPT OF IMPLEMENTATION IN EC LAW

THE EFFECTIVENESS OF any legal system is based on two principles: *compliance with* and *implementation of* the legal rules of that order. Yet, while the treaties establishing the European Union (EU) and its component part, the European Community (EC), address the question of compliance,[1] implementation is only exceptionally dealt with in connection with a specific policy.[2] The reference in Article 10 ECT to implementation as part of the more general obligation of Member States to comply with EU law is frequently misread as establishing a general competence of the Member States over the implementation of EC law. The standard answer to questions about the power to implement EC law is, accordingly, that '[t]he Member States are responsible for implementing Community Law except where the task has been expressly assigned to a Community institution or body'.[3]

This understanding, however, follows neither from the wording, nor from the context of Article 10 ECT, nor from any other provision of the Treaties, and legal and administrative reality suggests otherwise. For example, the demarcation of implementation, on the one hand, from the exercise of autonomous powers by the EC institutions and national authorities, on the other, is elusive. Similarly ill-defined are the acceptable limits on EU law's impact upon the political and administrative structure of the Member

[1] See Art 7 TEU, Art 10 ECT, 226 ECT, 248 III ECT.
[2] See, eg Art 280 II ECT (protection of financial interests of the EC).
[3] K Lenaerts and P Van Nuffel, *Constitutional Law of the European Union* (London, Sweet & Maxwell, 1999) 392.

States. Finally, no clear pattern determines the role of sub-state actors (public and private) in the implementation of EU law.

These questions have particular resonance due to the fact that the European Court of Justice (ECJ), interpreting Article 10 ECT, has ruled that national governments are and must be held liable for any breach of their obligation to implement Community law. Such exposure subsists even when Member States entrust the task of implementation to other bodies, such as local administrations, professional associations and private parties.

By the way of general limits on Member States' autonomy in implementing EC law, the ECJ has established two main principles: the principle of the full effectiveness of EC law and the principle of non-discrimination.[4] However, additional limits rooted in EU law may be envisaged. Is it permissible, for example, for EC legislation to impose further conditions on the exercise of implementing powers? May it lay down substantive and /or procedural rules of implementation? May it impose specific methods of implementation on the Member States, such as establishing the participation of private associations? May it mandate a decentralised implementation by regional and local authorities? May it even foster new governance structures for the sake of making implementation more effective? What are the legal and conceptual justifications for any such restrictions on the discretion of the Member States in determining how to implement EU law? Do such restrictions render the Member States' discretion in deciding how to implement EC law illusory? How are EC interventions of this sort themselves to be limited? And how can they be prevented from unduly interfering with the Member States' performance of their responsibilities?

The implementation dimension of EC legislation is apparent from any random sample drawn from the Official Journal of the European Union. Decision 253/2003/EC[5] establishing an action programme for the professional training of customs officers requires Member States to report on the best administrative methods and on benchmarking. Directive 2002/96/EC on electronic waste,[6] in addition to laying down explicit rules on inspection and review of implementation, contemplates the possibility of implementation by private parties.

The enlargement process has only made the EU's intervention into matters of implementation more conspicuous. The EU has been nothing

[4] See n 8 below.
[5] Decision No 253/2003/EC of the European Parliament and of the Council of 11 February 2003 adopting an action programme for customs in the Community [2003] OJ L36 (Customs 2007) Arts 6,10.
[6] Directive 2002/96/EC of the European Parliament and of the Council of 27 January 2003 on waste electrical and electronic equipment (WEEE) — Joint declaration of the European Parliament, the Council and the Commission relating to Article 9 [2003] OJ L37/24, Arts 16,17.

less than massively involved in shaping the administrative structures and procedures of the new states, even through design of those structures and procedures falls squarely, according to tradition, within the sphere of national responsibility. The question that arises is whether this involvement should be viewed as part of 'preparation for accession' (hence a more or less singular event that will come to an end once accession occurs) or reflects a more durable pattern.

We doubt that the EU's involvement in the new states' administrative practices should be viewed quite so narrowly. Precisely because this involvement coincides with the broader legislative trends described above, even as regards the expanded Europe of 15, we discern a more general pattern of heightened EU involvement in national administration. Legislation preparatory to accession may therefore presage a more fundamental evolution and, to that extend, serve as a laboratory for examining this new aspect of the EU and Member State relationship.[7]

The stakes are necessarily high. The inherent complexity of any system of multilevel governance puts compliance with legal rules at risk. This is particularly true for legal systems which — like the EU — are not predominantly based on sanctions, but rather on an assumption of active cooperation on the part of all public and private actors within the Member States. In such systems, new governance structures within civil society, including at the 'grassroots' level, can stimulate the cooperation impulse. Accession provides an opportunity to experiment with new methods for securing compliance that complement the EU's existing sanctions-based mechanisms in a way that is more reflective of this notion of voluntary cooperation. The introduction of such methods in the relationship between the EU and the present Member States may serve to enhance patterns of compliance in those states as well.

This paper thus examines the legislation adopted by the EU in order to prepare for accession in light of this hypothesis, with an emphasis on the potential costs and benefits associated with the EU's growing influence on the shaping of national administrations. The paper is divided into two parts. In the first part, we trace the evolution of the traditional concept of implementation of EC law by the Member States and of mechanisms put in place to enhance compliance with EC law. The second part is devoted to the accession states, examining the legislative techniques used by the EU to prepare and facilitate accession. The subject is rich, since much more attention has been paid to preparing for implementation and compliance than in previous accessions and a number of new 'implementation techniques' have been introduced.

[7] See European governance — a White Paper COM (2001) 428 final (12 October 2001) OJ C287/1, 25 (White Paper).

In sum, while preparation for accession of the new Member States may at first sight appear to be only distantly connected to general issues of implementation and compliance, it is not. On the contrary, concern over implementation and compliance will survive the accession of these states. They may have only prepared the ground for a generalisation of methods for implementation and compliance based on a model of 'mixed governance'. A full-fledged institutionalisation of such a model, however, requires a stronger constitutional basis, and was an issue that was properly dealt with by the European Convention on the Future of the Union.

THE CONCEPT AND EVOLUTION OF COMPLIANCE AND IMPLEMENTATION WITHIN THE EU

Invoking the principle of cooperation laid down in Article 10 ECT, the Court of Justice has consistently held that the Member States have the authority, as well as the responsibility, to ensure the legal protection which individuals derive from the direct effect of European Community law. In the absence of Community rules governing a matter, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction over actions asserting Community law claims and to lay down the detailed procedural rules governing such actions. At the same time, however, such rules must not be less favourable than those governing similar domestic actions and they must not render virtually impossible or excessively difficult the exercise of rights conferred by Community law.[8] This case law highlights the limits, under the EC Treaty, on the institutional and procedural autonomy of the Member States in

[8] See eg Case 94/71 *Schlüter & Maack* [1972] ECR 00307 para 10; Case 33/76 *Rewe* [1976] ECR 01989 para 5; Case 45/76 *Comet* [1976] ECR 02043 para 12; Case 265/78 *Ferwerda* [1980] ECR 00617 para 10; Case 68/79 *Hans Just* [1980] ECR 00501 para 18; Case 61/79 *Denkavit* [1980] ECR 01205 para 25; Cases 119/79 and 126/79 *Lippische Hauptgenossenschaft* [1980] ECR 01863 para 5; Case 811/79 *Ariete* [1980] ECR 02545 para 12; Case 54/81 *Fromme* [1982] ECR 01449 para 6; Cases 146, 192 and 193/81 *BayWa* [1982] ECR 01503 para 29; Case 199/82 *San Giorgio* [1983] ECR 03595 para 12; Cases 331, 376 and 378/85 *Bianco* [1988] ECR 01099 para 12; Case C-96/91 *Commission v Spain* [1992] ECR I-3789 para 12; Cases C-430 and C-431/93 *Van Schijndel* [1995] ECR I-4705 para17. Concerning penalties see Case C-68/88 *Commission v Greece* [1989] ECR 02965 para 22. See also Case 203/80 *Casati* [1981] ECR 02595 para 27; Case C-326/88 *Anklagemyndigheden v Hansen & Soen I/S* [1990] ECR I-02911 para 17; Cases C-6/90 and C-9/90 *Francovic and Bonifaci* [1991] ECR I-05357 paras 42 and 43; Case C-7/90 *Vandevenne* [1991] ECR I-04371 para 11; Case C-210/91 *Commission v Greece* [1992] ECR I-06735 para 19; Case C-382/92 *Commission v United Kingdom* [1994] ECR I-02435 para 55; Case C-383/92 *Commission v United Kingdom* [1994] ECR I-02479 para 40; Case C-312/93 *Peterbroeck* [1995] ECR I-04599 para 12; Case C-36/94 *Siesse* [1995] ECR I-03573 para 20; Case C-213/99 *De Andrade* [2000] ECR I-11083 para 19; Case C-354/99 *Commission v Ireland* [2001] ECR I-07657 para 46; Case C-374/99 *United Kingdom v Commission* [2001] ECR I-05943 para 33.

implementing EC law. Moreover, according to the Court, the same obligation to protect fundamental rights that attaches to action at the Community level also attaches to actions by the Member States when they implement Community law rules.[9]

Although the instances in which European institutions execute EC law themselves are growing in importance, the Member States remain primarily entrusted with the task of implementing European policies.[10] As we have seen, national authorities act pursuant to the procedural and substantive rules of their own national law insofar as Community law, general or specific, does not provide common rules to this effect. Sometimes, the EC legislature has exploited this possibility by developing various means — both 'coercive' and 'soft' — for ensuring compliance and adequate implementation.[11]

'Coercive' Means

The term 'coercive means' denotes those requirements of EC legislation which restrict the Member States' autonomy in implementing EC law, and whose respect is ensured by the EC Treaty's provision on direct enforcement, ie Article 226. The Community's interference in the implementation of EC law by national administrations varies greatly in scope and intensity. At one end of the spectrum, we find mere reporting requirements whose purpose is to provide the Commission with comprehensive information on compliance and implementation. Member States accordingly must notify the Commission, either automatically or by request, of the state of implementation of Community law on their territory.[12]

By way of example, Regulation 3820/85/EC on the harmonisation of certain social legislation relating to road transport[13] requires the Commission to produce a report every two years on the Regulation's

[9] Case C-205 to 215/82 *Deutsche Milchkontor Gmbh* [1983] ECR 2633 para 32. See also Case 94/87 *Commission v Germany* [1989] ECR 00175 para 12; Case C-298/96 *Oelmühle and Schmidt Söhne* [1998] ECR I-4767 para 24; Cases C-80, C-81 and C-82/99 *Flemmer* [2001] ECR I-07211 para 55; Case C-382/99 *Kingdom of the Netherlands v Commission* [2002] ECR I-05163 para 90; Case C-336/00 *Huber* [2002] ECR I-07699 para 55.

[10] S Kadelbach, 'European Administrative Law and the Law of a Europeanized Administration' in C Joerges and R Dehousse (eds), *Good Governance in Europe's Integrated Market* (Oxford, Oxford University Press, 2002) 170.

[11] Among 'coercive' means we mention also the situation of an indirect impact on national administration structures.

[12] In addition to this 'institutionalised supervision', an 'individualised supervision' is provided through the mechanism of individual complaint. Citizens can directly inform the Commission about infringements of European rules made by national administrations. See http://www.europa.eu.int/comm/secretariat-general/sgb/lexcomm (15 May 2003).

[13] Council Regulation (EEC) 3820/85 of 20 December 1985 on the harmonization of certain social legislation relating to road transport [1985] OJ L370/001, Art 16.

implementation by Member States and on developments in the fields in question. To enable the Commission to do so, Member States must in turn submit the necessary information to the Commission every two years, following a standard form.[14]

Commission supervision of Member State implementation of EC law can also take a more intrusive form. In some cases, the Commission is empowered by EC law to examine whether national authorities and economic actors have fulfilled their duties towards the Community. For example, according to Council Regulation 1026/1999/EC, the Commission appoints so-called 'authorised agents' to carry out controls and inspections of the Communities' own resources.[15] Member States are expected to see to it that their relevant departments or agencies provide the Commission's authorised agents with the assistance necessary for carrying out their duties. The results of the agent's on-the-spot controls and inspections are brought to the attention of the Member States, which may then submit their observations within a period of three months following receipt of the communication.

EC Legislation may impose still more intense limitations on the Member States' autonomy in implementation. For example, it may directly regulate the procedural mode of national implementation. Council Regulation 2913/92/EC, establishing the Community Customs Code[16] lays down detailed procedural rules leaving no discretion to the national administration. EC legislation may even go so far as to impose organisational requirements on the national administrations. Directive 95/46/EC mandates Member States to entrust the task of monitoring compliance with data protection principles to one or more independent authorities having powers and responsibilities detailed in the directive.[17]

At the far end of the spectrum we find those cases in which, even though the Member States retain general competence for implementation, the Commission has authority, under certain conditions, to exercise powers of implementation directly, in effect substituting itself for the

[14] It should be noted that in many instances the reporting mechanisms we have referred to have failed to function properly, due to inaccuracy or inertia on behalf of the national administration (European Commission, Report on the application of Regulation 3820/85/CE). On the limits of the Commission's power to request reporting by the Member States, see Case C-303/90 *France v Commission* [1991] ECR I-5315 paras 19–35.

[15] Council Regulation (EC, Euratom) 1026/1999 of 10 May 1999 determining the powers and obligations of agents authorised by the Commission to carry out controls and inspections of the Communities' own resources [1999] OJ L126/1.

[16] Council Regulation (EEC) 2913/92 of 12 October 1992 establishing the Community Customs Code [1992] OJ L 302/1. See generally A David, *Inspektionen im Europäischen Verwaltungsrecht* (Berlin, Duncker und Humblot, 2003).

[17] Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data [1995] OJ L281/31, Art 28.

national administration. Directive 2001/95/EC on general product safety [18] illustrates the point. Article 8 of the directive calls upon Member States to take all appropriate measures in order to prevent dangerous products from being placed on the market, and to withdraw them if they are already in commerce. However, if the Commission becomes aware of a serious risk from certain products to the health and safety of consumers, it may instruct the Member States to take measures that it — the Commission — deems appropriate. According to Article 13 of the directive, this is the case if, at one and the same time, three conditions are satisfied. Firstly, it must emerge from prior consultations with the Member States that they differ significantly on the approach adopted or to be adopted to deal with the risk. Secondly, the risk must not be able to be dealt with by means of other procedures laid down by the specific Community legislation in a manner compatible with the degree of urgency of the case. And finally, the risk must be one that can only be eliminated by adopting appropriate measures applicable at Community level.

All of these requirements are of course supported by the enforcement procedure provided for by Article 226 of the EC Treaty. This procedure, it will be recalled,[19] has a threefold purpose. Firstly, and most obviously, it aims to ensure compliance by Member States with their Community obligations. Secondly, by requiring the Commission to follow a pre-litigation administrative stage before instituting proceedings before the Court, it provides a valuable non-judicial procedure for resolving disputes between the Commission and the Member States. Thirdly, it inevitably serves as one among the various means of clarifying the law for the benefit of all Member States and indeed of all interested persons.[20]

Finally, coercive means may also have implications for national administrations that are not explicitly identified as corresponding to the legislative purpose. For example, Member States are required to provide economic and social data to the EU, which are assembled according to 'data units',[21] which correlate to economic, geographical and other categories established objectively at the EU level. One such unit is 'NUTS' (Nomenclature of Statistical Territorial Units).[22] The sole fact of aggregating and publicising regional data for all Member States has contributed to the development of

[18] Directive 2001/95/EC of the European Parliament and of the Council of 3 December 2001 on general product safety [2002] OJ L11/4.
[19] See J Steiner and L Woods, *Textbook on EC Law* (London, Blackstone Press, 2000) 492.
[20] On the types of violation which are likely to trigger the Art 226 process, see S Douglas-Scott, *Constitutional Law of the European Union* (Harlow, Pearson Education, 2002) 409–14.
[21] See Art 2 of Council Regulation (EEC) 696/93 of 15 March 1993 on the statistical units for the observation and analysis of the production system in the Community [1993] OJ L76/1.
[22] *Ibid*, Annex, s II B 3. An example for the use of 'NUTS' in other fields is Council Regulation (EC) 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds [1999] OJ L161/1, Art 3.

a regional consciousness within national administrations and to a strengthening of regional identity. This, in turn, may have a positive influence on compliance and implementation in other EC law fields.

'Soft' Means

Complementing these more or less coercive means of ensuring the implementation of EC law are a variety of what may be termed 'soft' means.[23] By this term we encompass all EC law measures designed to encourage or facilitate national implementation of EU law and policy, or to guide Member States efficiently through the implementation process. Such means do not oblige Member States to act in a specific way under threat of sanction, but they are meant to induce Member States to achieve adequate implementation. They share in common what has been called 'a more indirect approach towards achieving behavioural change'.[24]

The classic examples of 'soft' means are guidelines. For instance, the above-mentioned Directive 2001/95/EC on general product safety[25] imposes a general obligation on economic operators to place only safe products on the market. According to Article 3 of the directive, a product shall be deemed safe when, in the absence of specific Community provisions governing the safety of the product in question, it conforms to the specific rules of national law of the Member State in whose territory the product is marketed. At the same time, however, the laws of the Member States may well differ in the level of protection afforded to consumers, thereby creating barriers to trade and distortion of competition within the internal market. In order to overcome this difficulty, the directive provides that a product shall be presumed safe if it conforms to national standards which transpose voluntary (ie non-binding) European standards established by European standardisation bodies under mandates issued by the Commission. In order to help ensure that products in compliance with the standards do indeed meet general safety requirements, the Commission, assisted by a committee composed of representatives of the Member States, fixes the requirements that the standards must meet.

Directive 2001/95/CE is thus an example of 'soft' means in that the EC seeks to achieve adequate implementation of its policy without resorting to coercive means. The relevant guidelines, while addressed to Member States, impose no formal obligation on the states to follow them. On the other

[23] See A J G Ibanez, 'Alternative Administrative Procedures and the Pursuit of Member States' (2000) 6 *European Law Journal* 148–75.
[24] C Knill and A Lenschow, 'Modes of Regulation in the Governance of European Union: Towards a Comprehensive Evaluation' (2003) 7 *European Integration online Papers* 1.
[25] Directive 2001/95/EC of the European Parliament and of the Council of 3 December 2001 on general product safety [2002] OJ L11/4.

hand, a Member State has an incentive to follow the guidelines, since, if it does, its laws automatically conform with the directive. This produces an important degree of legal security, in that the Member State will avoid any potential conflict over the adequacy of its introduction of the directive into national law.

In order to further improve the quality of implementation of EC law by national administrations, without resorting to coercion, the EC has also adopted a number of measures that encourage and support professional training. For example, Decision 253/2003/EC,[26] establishing an action programme for the professional training of customs officers, suggests various training measures, such as exchanges of national customs officials, benchmarking, and seminars and workshops. It also encourages a structured cooperation between national training bodies and officials responsible for customs training within national administrations, and to that end invites Member States, in cooperation with the Commission, to set training standards, develop training programmes and even establish customs training courses.

'Soft' instruments figure prominently in the Commission's 'White Paper on European Governance.'[27] Through the White Paper, the Commission has set out to reform its use of power in accordance with five principles: openness, participation, accountability, effectiveness and coherence.[28] To this end, the White Paper has devised certain innovative 'soft means' for implementing EC law at the Member State level.[29] A particularly interesting example is the use of 'target-based tripartite contracts' for the implementation of certain common policies.[30] Such contracts are to be 'concluded between the European Community (represented by the Commission), a Member State, and regional and local authorities in direct application of binding secondary Community law', and are meant to be used to implement 'policies whose territorial impact varies in accordance with (…) geographical, climatic or demographic circumstances'. The utility of these

[26] Decision No 253/2003/EC of the European Parliament and of the Council of 11 February 2003 adopting an action programme for customs in the Community (Customs 2007) [2003] OJ L36/1, Art 9.

[27] See European governance — a White Paper, above n 7. On the concept of governance see eg C Joerges and R Dehousse (eds), *Good Governance in Europe's Integrated Market* (Oxford, University Press, 2002); J Scott and D M Trubek, 'Mind the Gap: Law and New Approaches to Governance in the European Union' (2002) 8 *European Law Journal* 1. O De Schutter, N Lebessis and J Paterson (eds), *La Gouvernance dans l'Union européenne* (Luxembourg, Communautés européennes, 2001) and F Snyder (ed), *The Europeanisation of Law: The Legal Effects of European Integration* (Oxford, Hart Publishing, 2000).

[28] White paper, above, n 7, 3 and 10.

[29] *Ibid*, 25 and ff.

[30] *Ibid*, 13. See also Communication from the Commission — A framework for target-based tripartite contracts and agreements between the Community, the States and regional and local authorities COM (2002) 709 final.

contracts resides precisely in the fact that they closely involve regional and local actors whenever local knowledge is a key factor in the proper implementation of EC measures.[31] Needless to emphasise, the conclusion of such a contract is without prejudice to the responsibility of the Member State concerned to ensure the full implementation of EC law.[32]

The discussion thus far has focused on the implementation of EC law by public administrations, whether at the EC or the Member State level. Nevertheless, in recent years a new implementation concept has emerged, which also involves different actors, and more specifically the private sector. In its White Paper on Governance, in particular, the Commission announced an intention to rely on civil society, in the belief that churches and religious communities, trade unions and employers' organisations, non-governmental organisations, professional associations, charities and grassroots organisations all have a particular contribution to make to the effective implementation of EC law.

Of course, achieving this reform requires better information on European issues at the national and local levels.[33] New technologies, cultural changes and global interdependence have all fuelled the creation of a remarkable variety of European and international networks which link business, communities, research centres, and regional and local authorities. A more structured connection among these networks, and between them and the EU institutions, could make an effective contribution to policy implementation within the EU. Obviously, the EC legislation can go further, providing expressly for the possibility of implementing secondary legislation through the services of private parties.

Directive 2002/96/EC on electronic waste illustrates the point.[34] Article 6 of the directive instructs Member States to encourage establishments or undertakings which carry out treatment operations to introduce certified environmental management systems in compliance with Community law.[35] Member States are also to ensure that users of electrical and electronic equipment in private households receive the necessary information about waste electrical and electronic equipment (WEEE). In order to

[31] Communication from the Commission — A framework for target-based tripartite contracts and agreements between the Community, the States and regional and local authorities/ COM (2002) 709 final, (11 December 2002) 3.
[32] *Ibid*, 4.
[33] In particular, according to the Commission, Member States should promote public debate of European affairs, organise seminars and develop a better connection with European and international networks.
[34] Directive 2002/96/EC of the European Parliament and of the Council of 27 January 2003 on waste electrical and electronic equipment (WEEE) — Joint declaration of the European Parliament, the Council and the Commission relating to Art 9, [2003] OJ L37/24.
[35] See Commission Regulation (EC) 761/2000 of 12 April 2000 fixing the import duties in the rice sector [2000] OJ L114/1, allowing voluntary participation by organisations in a Community eco-management and audit scheme.

facilitate the reuse and the correct and environmentally sound treatment of WEEE, including maintenance, upgrade, refurbishment and recycling, Member States are to take all measures necessary to ensure that producers provide reuse and treatment information for each type of new electrical and electronic equipment (EEE) put on the market. This information — on treatment and recycling facilities that comply with the provisions of the Directive, on different EEE components, and on the location of dangerous substances and preparations in EEE — is made available to reuse centres, treatment and recycling facilities by producers of EEE in the form of manuals or by means of electronic media, such as CD-ROM and online services. Significantly, provided that the objectives of the Directive are achieved, Member States are free to transpose these provisions through agreements between the competent authorities and the economic sectors concerned, thus enabling private parties to play an important role in the directive's implementation.

Even primary law (ie treaty law) makes reference to the social partners and to civil society as potential actors in the implementation of EC law. Article 137 (3) of the EC Treaty expressly authorises Member States to 'entrust management and labour, at their joint request, with the implementation of directives' adopted under Article 137 (2).

Overall, their flexibility makes soft means highly useful in implementation terms. The regulator gains discretion, including the discretion to discard methods that prove unsuccessful. Soft means also allow policies to be operated at regional levels, thereby tailoring regulations to local and regional peculiarities and respecting local and regional cultures and senses of independence.[36]

Conclusion

In conclusion, the European institutions have developed a palette of both 'coercive' and 'soft' legislative means of guiding, influencing and controlling the Member States in their implementation of law and policy. While these effects sometimes flow even from legislative acts which do not explicitly pursue them, increasingly EC legislation expressly embraces them.

[36] See C Harlow, 'European Administrative Law and the Global Challenge' in P Craig and G De Burca (eds), *The Evolution of EU Law* (Oxford, Oxford University Press, 1999) 277. Against L Krämer, *Focus on European Environmental Law* (London, Sweet & Maxwell, 1992) and G Lübbe-Wolff, 'Stand und Instrumente der Implementation des Umweltrechts in Deutschland' in G Lübbe-Wolff (ed), *Der Vollzug des europäischen Umweltrechts* (Berlin, Erich Schmid Verlag, 1996) 77–106.

This evolution marks an important step toward joint EC/Member State responsibility for implementation of law and policy,[37] and highlights the fallacy of the simple dichotomy between the EU as regulator and the Member States as instruments of implementation. This complex reality of Union governance should not be viewed, however, as a deviation from some supposed 'original standard'. In fact, a complete autonomy of national administrations would be inconceivable in a system which, like the European one, is based on a legal unity resulting in large measure from the notion of mutual recognition. EU intervention remains necessary in the building of the mutual confidence which is an indispensable precondition for mutual recognition.

METHODS FOR SECURING IMPLEMENTATION AND COMPLIANCE IN ACCESSION COUNTRIES

The Political Framework

As early as June 1993, the Copenhagen European Council defined the criteria that applicant states would have to meet in order to join the Union.[38] They had, firstly, to meet the political criteria of a stable democracy, respecting human rights, the rule of law and protection of minorities.[39] Secondly, they required the capacity to sustain a functioning market economy. Finally, a prospective member must adopt the common rules, standards and policies that make up the *acquis communautaire*, including adherence to the aims of political, economic and monetary union.[40]

In order to be meaningful, formal adoption of the *acquis communautaire* must necessarily be followed by implementation and enforcement of its component policies and measures. The notion of effective implementation embraces all instruments which allow a country both to pursue the objectives of the Union and to determine whether the results in practice correspond to those that have been prescribed.

[37] On this point see L Azoulay, 'The Judge and the Community's Administrative Governance' in C Joerges and R Dehousse (eds), *Good Governance in Europe's Integrated Market* (Oxford, Oxford University Press, 2002) 134.
[38] Copenhagen European Council, Conclusions of the Presidency (Bull EC 6–1993, 13). See also J Stankovsky, F Plasser and P A Ulram, *On the Eve of EU Enlargement* (Wien, Signum Verlag, 1998).
[39] The first political criterion is considered to be a precondition for the opening of accession negotiations, while the other criteria need to be fulfilled by the time of membership.
[40] On the biggest challenges in terms of the 'constantly developing EU constitutional acquis', see J Czuczai, 'Practical Implementation by the Acceding Candidate Countries of the Constitutional Acquis of the EU. Problems and Challenges' in A E Kellermann, J W de Zwan and J Czuczai (eds), *EU Enlargement: The Constitutional Impact at EU and National Level* (The Hague, TMC Asser Press, 2000) 421.

Although the requirement of effective implementation has been a precondition for accession in all previous enlargements of the Union, it represents a particularly demanding one in the present context, both because the magnitude of the obligation in the Union is so much higher than in all prior enlargements and because all Central and East European States still carry, to different degrees, the burden of their recent history, affecting their economic, political and legal structures and capabilities.[41]

From a strictly legal point of view, a prospective Member State needs to comply with EC law only from the date on which the accession treaty enters into force. However, the specific situation of Central and Eastern European Countries has prompted the European Union to establish a formal pre-accession process, aiming in particular at strengthening the administrative capacities of the accession states.

As early as 1995, the Madrid European Council highlighted the importance of adapting the candidate states' administrative structures so as to create the conditions for their gradual and harmonious integration into the Union. In 2000, the Feira European Council specifically reiterated that 'progress in the negotiations depends on the incorporation by the Accession States of the *acquis* in their national legislation and especially on their capacity to effectively implement and enforce it'. In June 2001, the Göteborg European Council reemphasised the necessity that candidate states make continued progress in transposing, implementing and enforcing the *acquis*, and that they pay particular attention to setting up adequate administrative structures and reforming their judicial systems and civil services.

The Legal Instruments

Establishing and demonstrating effective implementation of EC law was not an easy task for the candidate states, particularly since no formal rule defines the concept of effective implementation and since transferring a mechanism which has proven to be useful in one country to another country is by no means a simple matter.[42] Moreover, national administrations are not all equally comfortable with the European legal framework against which effective implementation is to be measured. A good administration requires a proper understanding of European rules, coordination between European

[41] See P-C Müller-Graff, 'Legal Framework for relations between the European Union and central and eastern Europe: General aspects' in M Maresceau (ed), *Enlarging the European Union* (London, Longman, 1997) 35 and K A Armstrong, 'Governance and the Single European Market' in P Craig and G De Burca (eds), *The Evolution of EU Law* (Oxford, Oxford University Press, 1999) 752.

[42] See P Nicolaides, *Enlargement of the EU and Effective Implementation of its Rules* (Maastricht, European Institute of Public Administration, 2000) 3.

and national frameworks, and transparent and effective procedures. Notwithstanding the EU's involvement in shaping the administrative structures and procedures of candidate states, these goals were not easily achieved in the case of the Central and Eastern European states.[43]

The efforts of the Union in this regard bear a direct relationship to our subject matter. During the preparation for enlargement, the institutions deliberately sought to develop new methods, both 'coercive' and 'soft', to promote the proper implementation of EC law and ensure compliance with the *acquis* by the prospective Member States.

'Coercive' Means

As observed in the previous section, the *acquis* encompasses a wealth of 'coercive' requirements regarding the implementation of EC law, and compliance with them is ensured through the ordinary enforcement procedure provided for by the EC Treaty, notably Article 226 ff. Upon accession, the new states will have of course become fully subject to these requirements and to the Treaty's enforcement procedures. However, the acts of accession of the 10 new Member States contain special provisions designed to foster proper implementation of, and compliance with, EC law by these states.[44]

More specifically, the act of accession vests authority in the Commission, acting upon request of a Member State or on its own initiative, to 'take appropriate measures' when a new Member State fails to implement commitments undertaken in the context of the accession negotiations (Article 38), or when there appear shortcomings (or an imminent risk of shortcomings) in the transposition, implementation, or the application of any other commitments relating to mutual recognition in the area of criminal law under Title VI of the Treaty of the European Union or of any directives or regulations relating to mutual recognition in civil matters under Title IV of the EC Treaty (Article 39) . Where these conditions are present, the Commission may temporarily suspend the application of the relevant provisions or decisions in relations between the offending new Member State and any other Member State or states. These clauses should apply during a period of three years following the date of entry into force of the act of accession, and possibly even beyond that time if the abovementioned commitments have not been fulfilled.

The provisions just described are striking in their conferral upon the Commission of unprecedented repressive powers quite apart from the

[43] On the weaknesses of Candidate Countries, see A M Williams and V Balaz, 'Western Europe and the Eastern Enlargement' in D Hall and D Danta (eds), *Europe goes East* (London, The Stationery Office, 2000) 20.

[44] See Accession of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia [2003] OJ L236/33.

extreme breadth of wording of the enabling clauses, giving the Commission very wide discretion in deciding upon the nature and intensity of the 'appropriate measures'. Moreover, in contrast to Article 226 ff of the EC Treaty, these provisions enable the Commission to take action against non-compliant Member States without having to resort to the Court of Justice. They reflect transparently serious concerns over the ability of the new Member States to keep their commitments.

'Soft' Means

Particularly because the countries of Central and Eastern Europe are slowly evolving from centralised systems, they face a challenge in adapting what are themselves new domestic institutions to the new legal system which is the EU. The traditional 'hard' means of ensuring the implementation of European law may consequently not prove very effective. This has given the Union all the more reason to rely on what we have called 'encouragement measures' as part of the candidate states' preparation for membership.

Encouragement measures tend to be based on so-called *Accession Partnership Agreements*. An Accession Partnership Agreement is a multi-annual framework agreement which outlines the principles, priorities, and objectives of accession, and provides the funds, from all types of EU financial assistance, that will be needed to implement them. The agreements, which require Council approval, provide for *National Programmes for the Adoption of the Acquis (NPAA),* which fill in the details of what constitutes compliance with the *acquis* and with the Copenhagen criteria, and which provide the resources necessary for achieving that compliance. The NPAA must take into account broad policy documents such as the *Pact against Organised Crime* or *Joint Employment Policy Reviews*. The most important encouragement measures that complement these NPAA are the programmes known as PHARE,[45] ISPA,[46] and SAPARD.[47]

The PHARE programme, the largest of these, was established in 1989 to provide financial and technical assistance for economic and political transition. Initially directed only to two accession countries, the programme was

[45] See Council Regulation (EEC) 3906/89 of 18 December 1989 on economic aid to the Republic of Hungary and the Polish People's Republic [1989] OJ L 375/11.
[46] See Council Regulation (EC) 1267/1999 of 21 June 1999 establishing an Instrument for Structural Policies for Pre-Accession [1999] OJ L161/73, modified by Council Regulation (EC) 2382/2001 of 4 December 2001 amending Regulation (EC) 1267/1999 establishing an Instrument for Structural Policies for Pre-Accession [2001] OJ L323/1.
[47] See Council Regulation (EC) 1268/1999 of 21 June 1999 on Community support for pre-accession measures for agriculture and rural development in the applicant countries of central and eastern Europe in the pre-accession period [1999] OJ L161/87. See also *The enlargement process and the three pre-accession instruments: PHARE, ISPA, SAPARD* (Brussels, European Commission Enlargement Directorate General, 2002).

expanded to all 10 in 1996. PHARE funding has only supported projects that contribute to the accession process, many of them technical in nature and carried out by private enterprise and consultancy firms. PHARE support is currently focusing on two key areas: institution building and investment support. The former, in particular, denotes adapting and strengthening democratic institutions, public administration and organisations bearing responsibility for implementing and enforcing Community legislation. It accounts for about 30 per cent of PHARE funding.[48]

ISPA, or the Pre-Accession Instrument for Structural Policies, targets two areas: environment (in particular, compliance with EU regulations) and transport (in particular, improved connectivity with Trans European networks). The Special Accession Programme for Agriculture and Rural Development (SAPARD), on the other hand, aims to help the accession states prepare their rural sectors for EU membership by, for example, improving farm structures and promoting the development of alternative sources of income and employment in rural communities. To this extent, it resembles the EU's Rural Development Regulation. In order to receive SAPARD funding, a state has had to devise a development programme for rural areas for the period of 2000–2006, setting out the state's rural development strategy and the latter's impact on environmental, social and economic concerns. SAPARD represents an opportunity for the accession states to gather experience in the implementation, administration, monitoring and control of EU funding mechanisms. These programs will continue at least until 2006.[49]

Twinning Arrangements[50]

All of the programs just discussed have the particularity of encouraging Member States to share with the accession states their best practices in implementing measures. They achieve this through methods known as 'twinning arrangements,' which are based on quite a simple idea. In partnership with both the existing Member States and the accession states, the Commission has developed a system whereby those who apply the *acquis* in the existing Member States, either as part of their administrative functions or as members of professional associations, share their expertise with the accession states. Such transfer of technical and administrative

[48] See eg The Phare 2000 Review: Strengthening Preparations for Membership, Commission Document C (2000) 3103/2.
[49] See Commission Decision on the review of the guidelines for implementation of the PHARE programme in candidate countries for the period 2000–2006 in application of article 8 of Council Regulation (EEC) 3906/89, C(2002) 3303/2.
[50] See generally *Twinning in action* (Brussels, European Commission Directorate General for Enlargement, 2001).

knowledge helps the latter develop their own capacity to meet the obligations of European Union membership, while at the same time forging long-term relationships with the existing Member States.

Known as Pre-Accession Advisors, these Member State experts work in accession state ministries alongside their future colleagues for one or two years on specific projects. They in turn are supported by a senior project leader in their home administration who is responsible for overseeing the project as a whole and for coordinating all other input from the Member State. The project combines different means, including short-term expertise, training, services (such as translation and interpreting) and specialised help (such as specialised computer software). As needed, twinning may also entail traineeships for accession state officials with administrations, schools and professional bodies in the Member States. The costs of twinning are covered by the PHARE programme.

The Commission exercises its own oversight of the twinning process through a network of national contact points. Each Member State and accession state has appointed a representative, ensuring the proper flow of information through the network. Each accession state has had to assess its priority needs, focusing on the areas set out for action in its Accession Partnership and in the corresponding NPAA.

Once offers of assistance have been sent to the accession states, and after discussion between all the parties, each accession state chooses the offer which corresponds best to its needs. In some cases, two, and exceptionally even three, Member States may join forces in providing assistance. An accession state may also invite Member States offering different elements of support to combine them in a single project. Once the project has been chosen, the 'twins' elaborate a detailed work programme in the form of a covenant and submit it to the Commission for final approval. Twinning operates on the basis of two documents: a Framework Agreement between the Commission and each Member State and a Twinning Covenant between the accession state and the Member State. The agreement defines the terms and conditions (such as salaries and expenses) under which Member States make Pre-Accession advisors and other staff available to the accession state. The Covenant in turn sets out the result to be delivered by the project, the means to be used, and a detailed budget.

Twinning originally focused chiefly on four areas of the *acquis* (agriculture, environment, finance, and justice and home affairs) in each accession state.[51] In the field of the environment, a twinning project was begun in the summer of 2000 among Hungary, Finland and Spain, the aim being implementation in Hungary of the EU's two main directives on nature protection — the so-called Birds Directive and Habitats Directive. These

[51] For details concerning these projects, see *Twinning in action* (Brussels, European Commission Directorate General for Enlargement, 2001).

two legal instruments form the legal basis for NATURA 2000, a network of protected areas in the European Union covering fragile and valuable natural habitats of flora and fauna and species of particular importance for the conservation of biological diversity. Hungary wanted to benefit from the diversity of geography and experience of its 'twins'. The project entailed various actions: planning, training, execution and information distribution, including an awareness programme to prepare the public for NATURA 2000. The two Pre-Accession Advisors, Carlos Villalba, from the Spanish Conservation Agency, and Outi Airaksinen, from the Finnish Environment Institute, while citing the project's good results, maintained that the target would be achieved only if Hungary showed a serious commitment to the process.[52]

A second core area for twinning is justice and home affairs, particularly their security dimension, which is a matter of particular relevance both to old and new Member States. Several twinning projects accordingly have focused on problems associated with border controls. Illustrative is a project between Finland and Lithuania establishing a 12-month partnership between the Pre-Accession Advisor Hanno Lavia, a Finnish border guard, and the Lithuanian border police. The project sought to implement expert cooperation and training programmes, with follow-up, and to render advice on necessary legislative reform. It has enabled border police to assess their work in terms of efficiency, productivity, cost-effectiveness and net results, while facilitating the enactment of new border-guarding legislation.[53]

However, twinning has more recently been expanded to cover the whole of the *acquis communautaire* in its wider sense. For example, a twinning project 'Supplier Linkage and Upgrading' has been established between the Czech Republic and the United Kingdom. Miroslav Somol, Czech Vice Minister of Industry and Trade, and Martin Jahn, General Manager of CzechInvest, headed the Czech side, while Mike Harvey and Steve Martin from the UK Department of Trade and Industry served as Pre-Accession Advisors. The Sheffield Business School furnished technical expertise. The project, which was launched in January 2001, and ended on 31 July 2002, aimed at increasing the competitiveness of Czech small and medium sized enterprises (SMEs) in the electronics sector by developing their capacity to supply multinational companies that had been attracted to the Czech Republic as a manufacturing base. Unlike most twinning projects, which focussed on the capacity of accession state

[52] For details, see S Rientjes and I Bouwma, *Establishing Natura 2000 in EU Accession Countries* (Tilburg, ECNC, 1999) and 'Enlarging the Environment' Newsletter from the European Commission on Environmental Approximation (DG XI, Issue 14, July 1999).

[53] For details, see 'The Twinning Project 1999–2000 between the Lithuanian Border Police and the Finnish Frontier Guard' *Pasienis Lithuania* <http://www.pasienis.lt/english/other/twins.htm> (11 November 2003).

administrations to meet the obligations of membership, this project primarily sought to develop the capacity of indigenous industry to meet the challenges of EU membership.

Support from Czech companies and multinationals alike has been very encouraging and the programme has yielded many important lessons. Basically, the programme succeeded in assisting Czech companies by enhancing their attractiveness as suppliers to large multinational companies and their capacity to deliver. The European Commission and CzechInvest thereafter agreed to move the programme to a new phase, which began in autumn 2003.[54]

Although these three projects represent only a small selection of the many twinning projects over the last few years, they effectively illustrate the flexibility of the twinning mechanism. This feature permits adaptation to the specific characteristics of national situations. While accession states still encounter difficulties in adapting their national legislations to a new legal order, so far the twinning projects have accelerated and smoothed the process.

Twinning undoubtedly constitutes the best example of 'soft' means developed in the specific context of enlargement. Contributing to the diversity of encouragement measures already in use in the Union, this method promises quite rapid and tangible results.

Professional Training Measures and Cooperation Among Administrations

Twinning arrangements are by no means the only vehicle of financial support that the EU is making available to the accession states. Many professional training programmes originally addressed to Member States have now been expanded to the accession states, while new programmes are typically being addressed to both member and accession states. The Odysseus, Argo and Grotius programmes are examples of the latter. The aim of all these programmes is to strengthen trust and cooperation among administrations through exchange of staff, seminars and joint training.[55]

The Odysseus programme, adopted by the Council on 19 March 1998,[56] and covering the period of 1998 to 2002, entailed training, exchange of

[54] A detailed review and reflection of the programme, including a series of small case studies on 20 of the companies who have been involved so far was published in the Czech review Ekonom <http://www.ekonom.hned.cz> (15 May 2003). Following this publication *CzechInvest* invited companies and multinationals that would like to be involved in Phase II to make contact to discuss their suitability for involvement. On the programmes addressed to SMEs, see *The Small and Medium-size Entreprise* (Brussels, European Commission Enlargement Directorate General, 2001).

[55] See on this point M Anderson, 'Trust and Police Co-operation in Police and Justice' in M Anderson and J Apap (eds), *Police and Justice Co-operation and the New European Borders* (The Hague, Kluwer Law International, 2002) 35–46.

[56] Joint Action of 19 March 1998 adopted by the Council on the basis of Art K.3 of the Treaty on European Union, introducing a programme of training, exchanges and cooperation in

officials, cooperation in the field of asylum, immigration and crossing of external borders, studies and research.[57] In 1998, Odysseus financed 49 projects, out of a total of 75 applications. When the programme, whose projects the Commission was responsible for implementing, ended in 2002, a new action programme, called Argo, took over.

The Argo action programme,[58] covering the period of 2002 to 2006, promotes administrative cooperation between national services responsible for implementing Community rules in the areas governed by Articles 62 and 63 of the EC Treaty, namely visas, asylum and immigration. The underlying idea is that the transparency of actions taken by national agencies will be advanced through a strengthening of those agencies' relations with the relevant national and international governmental and non-governmental organisations. Of particular relevance in the present context is Argo's support for training actions though the elaboration of harmonised curricula and common core-training programmes at the national level. Some actions aim especially at making national agencies receptive to the best working methods and techniques developed in other Member States. Others promote the use of computerised handling of files and procedures (including use of the most current techniques of electric data exchange) or the establishment of information points and websites. Contemplated also are studies, research, conferences and seminars involving the staff of the relevant national and international governmental and non-governmental organisations.

Similar actions in the field of legal practice have been developed under the Grotius programme.[59] The Council set up this programme of incentives and exchanges on 28 October 1996, and it ran from 1996 to 2000.[60] The objective of Grotius was to facilitate judicial cooperation between member

the field of asylum, immigration and crossing of external borders [1998] OJ L99/2 (Odysseus-programme).

[57] Ranging from basic training to top-level specialist training and training for instructors.

[58] See Council Decision 2002/463/EC of 13 June 2002 adopting an action programme for administrative cooperation in the fields of external borders, visas, asylum and immigration [2002] OJ L161/11 (ARGO programme); and Annual Work Programme and Call for Proposals 2002 Argo [2002] OJ C195/16.

[59] See Joint Action 96/636/JAI of 29 October 1996 on a programme of incentives and exchanges for legal practitioners (Grotius) [1996] OJ L287/3-6. A second phase of the programme called 'Grotius II-criminal' for judicial cooperation in criminal matters, has been adopted by the EU Council of Ministers on June 2001 (Council Decision 2001/512/JHA of 28 June 2001 establishing a second phase of the programme of incentives and exchanges, training and cooperation for legal practitioners [2001] OJ L186/1 (Grotius II Criminal)).

[60] With the entry into force of the Treaty of Amsterdam on 1 May 1999, judicial cooperation in criminal matters and judicial cooperation in civil matters got two distinct legal bases (Title VI TEU and Title IV of Part Three ECT). Therefore the aspects of the *Grotius* programme dealing with judicial cooperation in criminal matters are currently based on Art 34 of TEU. Aspects of the programme relating to judicial cooperation in civil matters are currently based on Arts 61 and 67 TEC.

and accession states of the European Union by promoting mutual knowledge of legal and judicial systems. It entailed a series of training programmes, exchanges, meetings, research and seminars involving judges (including examining magistrates), prosecutors, advocates, solicitors, academics and scientific personnel, ministry officials, criminal investigation officers, court officers, bailiffs and court interpreters.

Octopus is an example of a programme specifically addressed to accession states. This joint programme of the European Commission and the Council of Europe, designed to combat corruption and organised crime in states in transition, consisted of two distinct phases. During the first (1996–1998), problems related to organised crime and corruption, and government measures in response, were analysed, resulting in a first set of country by country recommendations. During the second phase (1999–2000), a series of seminars and study visits was carried out with a view to improving policies, legislation, institutions, standards and practices.[61]

All in all, professional training and cooperation between administrations has proved to be an important tool for improving cooperation and promoting mutual knowledge between member and accession states in the legal and law enforcement arenas. Governmental and non-governmental entities alike have accordingly encouraged the Commission to continue these initiatives.[62]

Monitoring

An important component of virtually all programmes consists of reporting and evaluating progress. Since 1998, the Commission has made accession state progress toward meeting the Copenhagen criteria a regular subject of monitoring, so as to determine progress in terms of the enactment of legislation and of implementation.[63] With a view to the equal treatment of all accession states, an objective appraisal of each country's situation, and general transparency, use is made for each criterion of a detailed standard checklist. The reports draw upon, and are cross-checked with, numerous sources, starting from information provided by the accession

[61] See 'Programme Octopus' *Council of Europe, Legal Affairs* <http://www.coe.int/T/E/Legal_Affairs/Legal_co-operation/Combating_economic_crime/ Programme_OCTOPUS> (11 November 2003).

[62] See Fourth report of the Commission to the European Parliament and the Council on the implementation of the Grotius, STOP and OISIN programmes and the third report to the European Parliament and the Council on implementation of Odysseus and the Falcone programmes (2000), Commission Staff Working Paper SEC (2001) 903.

[63] The Commission has developed a methodology for that purpose. See European Commission Agenda 2000: For a stronger and wider Union COM (97) 2000 final. <http://europa.eu.int/comm/agenda2000/index.htm> (16 February 2004).

states themselves, and including reports and evaluations from the European arliament, the Member States, and international and non-governmental organisations.[64]

The Commission's reports analyse the extent to which the accession states have adopted the legislative measures necessary for implementing the *acquis* and highlight what remains to be done in this regard. They also assess the extent to which these states have established administrative structures adequate for implementing the *acquis*. These reports are complemented by monitoring activities including peer review.[65] In the field of justice and criminal law, the Council has favoured a specific mechanism for collective evaluation of the accession states' application of the *acquis*.[66]

The principal criticism levelled at reporting and monitoring as instruments is that 'they provid[e] merely a negative record of non-compliance and fail … to build in positive recommendations or to supply material support towards improved performance'.[67]

Conclusions

We may conclude that the enlargement process has served as a useful laboratory for new methods to ensure proper implementation of EC law, stimulating Member States and the Commission alike to draw lessons from the best instruments and practices, build upon them and extend them to the Union more generally.

As we have seen, the act of accession provides both for extraordinary 'coercive' means, aimed at ensuring compliance by the new Member States during a transitional period, and for a variety of 'soft' measures designed to enhance the accession States' capacity to implement the *acquis*. Once the best instrument has been selected, the accent has been put on achieving a better cooperation among all the actors involved.

Moreover, the methods being retained and developed are also being complemented by new instruments developed specifically in this context. Increased intervention by the EU in the ways and means of national administration is a direction in which the relationship between EC law and national administration can be expected to evolve.[68]

[64] See Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries COM (2002) 700 final 9.
[65] *Ibid*, 27.
[66] See Joint Action 98/429/JHA of 29 June 1998 adopted by the Council on the basis of Article K.3 of the Treaty on European Union, establishing a mechanism for collective evaluation of the enactment, application and effective implementation by the applicant countries of the acquis of the European Union in the field of Justice and Home Affairs [1998] OJ L191/8.
[67] N Walker, 'The problem of trust in an Enlarged Area of Freedom, Security and Justice: A Conceptual Analysis' in M Anderson and J Apap (eds), *Police and Justice Co-operation and the New European Borders* (The Hague, Kluwer Law International, 2002) 30.
[68] See Commission Communication on better monitoring of the application of Community law COM (2002) 725 final.

CONCLUSION

Notwithstanding their importance, matters of implementation and compliance with EC law are not based on a solid legal basis in the Treaties. As is frequently the case in the evolution of EC law, this deficiency has led to a shared responsibility, or a 'mixed governance' among European institutions and national actors, public and private.

The result is a certain structured disorder. The EC institutions have shown creativity in developing instruments for improving implementation, including reporting requirements, professional training, cooperation with private associations, and the grant of subsidies. Many of those instruments were used intensively in the run-up to the accession of Central and Eastern European countries. The emphasis in that context on 'soft' measures has enabled the EU to test the efficiency of such instruments, and at the same time to stimulate development of new governance structures in the accession states.

The time is ripe to conceptualise the notion of implementation in a modern EU context. In the first place, legislative and institutional practice of the Union has rendered obsolete the received wisdom according to which Member States enjoy unfettered autonomy in determining how to implement EC law. European legislation has devised a number of 'coercive' and 'soft' measures for improving implementation of and compliance with EC law. This has resulted in an increased interference by the Union's institutions in what had long been considered the preserve of the Member States, or, if one prefers, in an increased cooperation among all the levels of government composing the Union.

Second, we have witnessed a remarkable diversification and strengthening of these forms of interference and cooperation. With respect to this development, the enlargement process has constituted an important laboratory for the institutions, especially the Commission. The difficulties of ensuring a successful enlargement have given the institutions the impetus to devise new mechanisms for enhancing implementation and compliance.

This development is not likely to be a transient one. On the contrary, the availability of a wider spectrum of instruments of intervention will likely prove well adapted to the proper functioning of the Union in the future. At present, the Commission is actively engaged in an effort to transpose the most innovative and interesting of these solutions in the context of the debate on the future of the Union.

One area of particular Commission activity in this regard relates to enforcement procedures as such. Through a 'feasibility study' known as Penelope, prepared in the context of the debate on the future of the Union,[69] the Commission is examining new procedures for determining infringements.

[69] See 'Constitution De l'Union Européenne' *The European Union On-Line* <http://www.europa.eu.int/futurum/documents/offtext/const051202_fr.pdf> (12 November 2003).

If the Commission considers that a Member State has failed to fulfil an obligation, it would establish such failure by a formal decision, after giving the state in question the opportunity to submit its observations. The decision of the Commission would then be subject to review by the Court of Justice.[70] This would differ from current law and practice in the sense that the Commission would have the competence to decide itself on a Member State's failure, without having to submit the question to the Court of Justice for a formal decision.

Diversification in the means of compliance, in particular, responds to an important reality and need, in that the greater the spectrum and diversity of the activities of the Union and the greater the disparities among Member States' capacities to implement and comply, the greater the need for appropriately diverse implementing mechanisms. In this respect, the philosophy expressed by the Commission with regard to 'target-based tripartite contracts' is revealing. While uniformity may suit implementation issues surrounding 'core' policies of the internal market, greater flexibility may be called for as the impact of policies crucially depends upon geographic, climatic and demographic factors that are likely to differ from region to region.[71]

This trend toward greater differentiation among schemes for implementation, and improving implementation, is not, however, without risk.

One risk is that the empiricism and experimentation that have so far dominated the process may lead to intransparency, unaccountability and ultimately confusion. Confusion may, for example, arise as to the constitutional system that governs implementation in the Union. In this regard, coordination with the ongoing constitutional reform would appear to be useful. At the same time, however, the proper functioning of the Union requires that the constitutional context for the implementation of EC law not become too rigid. Simplistic or inflexible formulations in the drafting of the Constitutional Treaty need to be avoided, as this would leave the Union with an inadequate palette of instruments.[72]

Second, confusion may arise as to the implications of the various modes of implementation. Some models of implementation reflect considerable ambiguity. When, for example, the Commission presents 'target-based tripartite contracts' as favouring decentralisation and subsidiarity, it is correct insofar as tripartite contracts permit greater involvement of regional and local authorities. However, one must not lose sight of the fact that tripartite contracts also enable EU authorities to exercise closer scrutiny and control

[70] Penelope, Art 21 of supplementary institutional provisions, in A Mattera (ed), *"Penelope" Projet de Constitution de l'Union européenne* (Paris, Editions Clément Juglar, 2003) 311.
[71] COM (2002) 709 final, above, n 30.
[72] See eg draft Art 28 of 'Draft of Articles 24 to 33 of the Constitutional Treaty' *The European Convention* (Brussels, 26 February 2003) CONV 571/03.

of implementation at the national level, to the detriment, ultimately, of the Member States. This may be positive, but it is also a more or less concealed feature of this instrument.

More broadly, the launch of new means of ensuring implementation and compliance could conceivably prove to be counterproductive. Currently, the Member States remain the foundation and the guarantors of the implementation of EC law, notwithstanding the fact that ever greater limitations are being placed on their autonomy. They have, among other things, a monopoly in the legitimate use of force. The current trend for the European institutions to address themselves directly to other actors — including subnational and private ones — involved in implementation poses a risk. While diversification may complement existing patterns of implementation and compliance, it should not lead to substitution of the Member States. If for no other reason, it is hardly conceivable that the Commission would be able to monitor effectively the activities of such a large and diverse array of implementing actors.

The Commission seems to have taken notice of the problem, for it has repeatedly emphasised that the continuing responsibility of the Member States before the Union for implementation of EU law and policy is not open for discussion.[73] But, formal responsibility alone will not suffice. Member States will simply not be able to meet their implementation and compliance responsibilities if the decisional processes relating to these functions are taken out of their hands. In order for the system to function properly, care will therefore have to be taken to avoid bypassing the Member States entirely in the implementation process, even at the price of a possible reduction in the speed of implementation in the new Member States.

References

Anderson, M (2002) 'Trust and Police Co-operation in Police and Justice' in M Anderson and J Apap (eds), *Police and Justice Co-operation and the New European Borders* (The Hague, Kluwer Law International).

Armstrong, K A (1999) 'Governance and the Single European Market' in P Craig and G De Burca (eds), *The Evolution of EU Law* (Oxford, Oxford University Press).

Azoulay, L (2002) 'The Judge and the Community's Administrative Governance' in C Joerges and R Dehousse (eds), *Good Governance in Europe's Integrated Market* (Oxford, Oxford University Press).

[73] COM (2002) 709 final, above, n 30, 3.

Czuczai, J (2000) 'Practical Implementation by the Acceding Accession States of the Constitutional Acquis of the EU. Problems and Challenges' in A E Kellermann, J W de Zwan and J Czuczai (eds), *EU Enlargement: The Constitutional Impact at EU and National Level* (The Hague, TMC Asser Press).

David, A (2003) *Inspektionen im Europäischen Verwaltungsrecht* (Berlin, Duncker und Humblot).

De Schutter, O, Lebessis, N and Paterson, J (2001) *La Gouvernance dans l'Union européenne* (Luxembourg, Communautés Européennes).

Douglas-Scott, S (2002) *Constitutional Law of the European Union* (Harlow, Pearson Education).

Harlow, C (1999) 'European Administrative Law and the Global Challenge' in P Craig and G De Burca (eds), *The Evolution of EU Law* (Oxford, Oxford University Press).

Ibanez, A J G (2000) 'Alternative Administrative Procedures and the Pursuit of Member States' 6 *European Law Journal* 148.

Joerges, C and Dehousse, R (2002) *Good Governance in Europe's Integrated Market* (Oxford, Oxford University Press).

Kadelbach, S (2002) 'European Administrative Law and the Law of a Europeanized Administration' in C Joerges and R Dehousse (eds), *Good Governance in Europe's Integrated Market* (Oxford, Oxford University Press).

Knill, C and Lenschow, A (2003) 'Modes of Regulation in the Governance of European Union: Towards a Comprehensive Evaluation' 7 *European Integration online Papers*.

Krämer, L (1992) *Focus on European Environmental Law* (London, Sweet & Maxwell).

Lenaerts, K and Nuffel, PV (1999) *Constitutional Law of the European Union* (London, Sweet & Maxwell).

Lübbe-Wolff, G (1996) 'Stand und Instrumente der Implementation des Umweltrechts in Deutschland' in G Lübbe-Wolff (ed), *Der Vollzug des europäischen Umweltrechts* (Berlin, Erich Schmid Verlag).

Mattera, A (2003) *Penelope Projet de Constitution de l'Union Européenne* (Paris, Editions Clément Juglar).

Müller-Graff, P-C (1997) 'Legal Framework for relations between the European Union and central and eastern Europe: General aspects' in M Maresceau (ed), *Enlarging the European Union* (London, Longman).

Nicolaides, P (2000) *Enlargement of the EU and Effective Implementation of its Rules* (European Institute of Public Administration, Maastricht).

Rientjes, S and Bouwma, I (1999) *Establishing Natura 2000 in EU Accession Countries* (Tilburg, ECNC).

Scott, J and Trubek, D M (2002) 'Mind the Gap: Law and New Approaches to Governance in the European Union' 8 *European Law Journal* 1.

Snyder, F (1999) *The Europeanisation of Law: The Legal Effects of European Integration* (Oxford, Hart Publishing).

Stankovsky, J, Plasser, F and Ulram, P A (1998) *On the Eve of EU Enlargement* (Wien, Signum Verlag).

Steiner, J and Woods, L (2002) *Textbook on EC Law* (London, Blackstone Press).

Walker, N (2002) 'The problem of trust in an Enlarged Area of Freedom, Security and Justice: A Conceptual Analysis' in M Anderson and J Apap (eds), *Police and Justice Co-operation and the New European Borders* (The Hague, Kluwer Law International).

Williams, A M and Balaz, V (2000) 'Western Europe and the Eastern Enlargement' in D Hall and D Danta (eds), *Europe Goes East* (London, TSO).

—— (1999) 'Enlarging the Environment' Newsletter from the European Commission on Environmental Approximation (DG XI, Issue 14, July 1999).

18

*Accession's Impact on Constitutionalism in the New Member States**

ANDRÁS SAJÓ

IN LESS THAN 15 years, the former socialist states of East Central Europe and the Baltic have turned into solid democracies that satisfy the political criteria of European accession. Checks and balances are in operation, elections are free, and the mechanism of fundamental rights protection is in place. The prospect of integration into the EU helped fuel the constitutional rearrangement in all the affected countries and opened up new constitutional vistas for the European citizens of the region. In many respects, EU integration is comparable in importance to the creation of the democratic nation-states in the first place following the collapse of communism.

However, these democratic transformations were achieved with limited popular participation and without a strong republican commitment. Constitutional enthusiasm was almost absent in the formative process. Public opinion is uninterested, at best, as far as the values and practices of constitutionalism are concerned. It may well be that the presence of an enthusiastic constitutional debate is not required for forging lasting constitutional arrangements, but an apparent lack of constitutional commitment and passion among the citizenry might become a problem in the event that tyrannical or corrupt elites should ever attempt to govern.

The situation just described raises a series of questions. Is it reasonable to expect from accession a renewed constitutional commitment on a par with that observed at the birth of these new democracies, or are we merely facing a largely technical process that simply frames and codifies the de facto economic and social integration of these states? May one expect constitutional enthusiasm in countries where the right to

* This chapter reflects developments up to October 2003.

independent nationhood was only recently acquired, and where perhaps the strongest integrative element at play is a sense of 'national togetherness', that is a pre-political community of fate? Is the constitutionalisation of the integration process simply another consequence of the process currently taking place within the Union, namely the identification of 'a new format to safeguard the great achievements of the Nation State beyond national borders'?[1] May one justifiably expect the arrival of a *constitutional moment* in Central and Eastern Europe rather than just the emergence of a constitutional patchwork? Is such a moment a realistic expectation, considering that the European Union itself seems reluctant to offer a grand vision of a genuine European citizenship based on solidarity and common values, other than the values to be expected of a large unified market exhibiting conveniently generalised consumer behaviour?

This chapter considers the constitutional dimension of EU accession in the accession states. The primary country of reference is Hungary. In the first section, I review the constitutional conditions and requirements of accession including their implications for the problems of sovereignty and legitimacy. Included is a brief discussion of the domestic political process, for it too plays a limited role in framing our understanding of the constitutional problem, particularly as concerns constitutional amendment, ratification of entry, and public referenda. Section two turns to the unresolved constitutional problems of the new Member States' relationship to the EU. These include supremacy of EU law and potential conflict with national constitutional courts, constitutional problems of implementation, and constitutional mechanisms for handling eventual future amendments to the EU Treaty. In the final section, I evaluate the impact of these national constitutional changes on the domestic separation of powers.[2]

NATIONAL CONSTITUTIONAL POSITIONS RELATING TO EU MEMBERSHIP

'Europe Clauses'

With the exception of Estonia, all the accession states of Central and Eastern Europe enacted new national constitutions after the collapse

[1] J Habermas, *So, Why Does Europe Need a Constitution?* (Florence, European University Institute, 2001).

[2] I am not discussing here the human rights aspect of constitutionalism. Contrary to certain condescending and rather widespread Western European views, the impact of accession on the human rights protection system will not be remarkable, at least at the level of formal rights protection, for the simple reason that the accession countries do have an efficient rights protection system in their Constitutions.

of communism.[3] The Estonian Constitution (Article 1) and the Czech and Slovak constitutions (1992) declare the respective countries to be 'sovereign,' while Poland (1997), Hungary (1989 amendment), Latvia (1922), Lithuania (1992), and Slovenia (1991) refer to 'independence.' The Lithuanian Constitution further states that the people's sovereignty cannot be limited. Even where the constitution (as in Hungary, for example) is more equivocal, both the jurisprudence of the Constitutional Court and prevailing national sentiment more generally reflect a very traditional concept of sovereignty. Thus, while a transfer of the right to exercise certain powers is allowed, the transfer of public powers themselves is not possible because such a transfer is incompatible with the ultimate vesting of sovereignty in the Hungarian people.[4]

This preoccupation with state sovereignty as a basis for independence stands in contrast with Western European constitutions, in which the matter is either not discussed at all, is alluded to but not made explicit,[5] or is mentioned only in terms of its source.[6]

Considering that EU membership affects sovereignty, and arguably independence, those constitutional provisions are understandably viewed as a matter of concern, if not as an outright obstacle to integration. They reflect genuine and basic pro-independence sentiment among the populations of states enjoying newly recognised or regained sovereignty. The cultural and legal elite repeatedly emphasise independence as a fundamental constitutional value. For their part, opposition politicians are only too quick to evoke the issue in the hopes of tapping into a society whose popular culture deeply honours heroes of independence. Thus, both general public sentiment and ongoing political conflicts playing on that sentiment encourage a narrow drafting of constitutional amendments that are intended to accommodate the operations of the Union.

Poland was the first to create an express constitutional basis for accession by authorising state organs to delegate competences over certain matters by international agreement to international organisations or institutions.[7] The Polish Constitution foresees that such delegation may be accomplished either through Parliament (with the two houses of Parliament acting separately by qualified majority) or by referendum. The

[3] The Hungarian Constitution is technically the Constitution of 1949 but it was fully amended in 1989 with several additional revisions since then.
[4] See for example O Varhelyi, 'Hungary' in A Ott and K Inglis (eds), *Handbook on European Enlargement* (The Hague, TMC Asser Press, 2002) 257 at 264.
[5] The Austrian Constitution states (Art 1) that her legal order originates in the people. This, of course, can be seen as a reference to sovereignty. See also the Belgian Constitution, Art 33.
[6] Italian Constitution (Art 1); French Constitution (Art 3); Spanish Constitution (Art 1.2); Portugal is one of the few states in the region whose constitution makes a direct reference to state sovereignty.
[7] Polish Constitution, Art 90, on sources of law.

European Union is not specifically identified as constituting an 'international organisation,' but it is understood as such.

Adoption of the Polish Constitution in 1997 was the product of a complicated give-and-take among constitutional actors making concessions on all sides. The result is that those opposing EU accession on grounds of loss of sovereignty could not effectively mobilise against the Constitution on a single agenda item basis. All in all, the constitutional settlements may be regarded as an act of prudence.[8]

As early as 20 March 1998, the Sejm (the Lower House of the Polish Parliament) enacted a bill providing for Polish membership in the EU. The opening paragraph clearly delineated the perceived benefits of Polish membership, both to the nation and to the Union. Addressing sovereignty concerns, it proclaimed: 'Developing our own identity and maintaining Polish sovereignty, we long for [membership in] the EU, recognizing it as an organization that retains respect for diversity.'[9]

The Polish parliamentarians also set out Poland's expectations of the Union, describing the latter as composed of states, nations and societies, yet strong, unified and harmonious. The Sejm expressed confidence that accession could be possible in the short term, and indeed by October 2002, a draft law was submitted to the Sejm to organise the procedures for carrying out a national referendum on accession, as well as on matters of importance to the state, and on amendments to the constitution.

The 2002 Amendment of the Czech Constitution is broadly similar. It requires parliamentary approval of the ratification of international agreements that transfer powers of state bodies, without however, imposing a qualified majority requirement.[10] Slovenia did not settle upon its technique of accession until January 2003. The Constitution's 'Europe Clause' (amending Article 3) authorises an actual transfer of parts of the nation's sovereign rights, although only with the assent of a two thirds majority in Parliament. To that extent, Slovenia's constitutional settlement is the region's most far reaching.

[8] See M Wyrzykowski, 'European Clause: Is it a Threat to Sovereignty?' in M Wyrzykowski (ed), *Constitutional Cultures,* (Warsaw, Institute of Public Affairs, 2000) 267 at 268. Please also see M Wyrzykowski, 'EU Accession in Light of Evolving Constitutionalism in Poland' in ch 19.

[9] Other points of the Sejm's position are also interesting compromises (or signs of ambivalence): 'The *Sejm* of the Polish Republic eagerly anticipates the beginning of negotiations between Poland and the EU regarding membership. We express the conviction that [...] the planned deliberations [will] usefully contribute to the idea of European integration and benefit all Europeans, and Polish traditions, culture and economic potential will find greater potential within the EU to contribute to the shaping of a future, unified Europe.' See R Riedel, 'Staying the Course' <http://www.ce-review.org/00/18/riedel18.html> (5 November 2003).

[10] Constitutional laws may require approval by referendum; in other words there is a constitutional choice like in Poland. The Czech system, however, makes it dependent on the opposition to have referendum; the default is that the majority may simply ratify the implicitly Constitution-amending treaty.

The situation in Estonia, where the drafting of a constitutional amendment began as early as 1998, proved more delicate. Estonia's sovereignty, as defined by the constitution, is non-transferable and inalienable. The original draft, which only allowed participation in the EU 'as an association of states,'[11] was superseded in December 2002, by a general authorisation to accede, subject to ratification by referendum. Moreover, the future implications of Estonian membership remain unclear since accession is specifically made subject to the basic principles of the national Constitution. Significantly, the level of accession support in Estonia has been relatively low,[12] though eventually sufficient to permit membership.[13]

The Hungarian Constitution was amended in December 2002, in view of accession. The amendment, which required two thirds of all the votes in a single chamber Parliament, emerged from bitter conflict between the then governing coalition parties and the centre right opposition, which had been in power until May 2002 and was in fact responsible for negotiating most aspects of the accession. Upon losing office following the April 2002 general elections, the centre right parties accused the new government of not vigorously enough defending national interests. For its part, the government took the position that accession legally required a referendum (which was not actually the case) and advocated an amendment that would have transferred decision making to the European Union in accordance with the Union Treaty. The opposition argued that such an amendment meant a unilateral transfer of powers and would significantly weaken Hungary's sovereignty. In the end, the government made certain concessions. Thus, Article 2/A of the Hungarian Constitution states that Hungary may, in order to participate as a full member in the European Union, exercise certain constitutional competencies as necessary for exercising rights and satisfying obligations under the EU treaties in conjunction with the other Member States, and that these competencies might be exercised independently, through the institutions of the European Union. As adopted, the amendment avoided terms suggesting that the Republic could actually transfer ('surrender' or 'convey') its constitutional competencies. The final wording does not allow 'transfer' as such, and addresses only the forms of exercise of certain constitutional competencies.

While the references to jointly exercised competencies and to independent EU competencies do not add much substance, they do indicate a

[11] See A Albi, 'The Central and Eastern European Constitutional Amendment Process in Light of the Post-Maastricht Conceptual Discourse: Estonia and the Baltic States' (2001) 7 *European Public Law* 436.
[12] As of June 2003, only 44% were in favour. See *Baltic News Service* (22 January 2003) <http://www.gallup-europe.be/epm/epm_030620_analysis_en.htm> (6 November 2003).
[13] 66.84% voted yes while the turnout was 64.02%, See *Gallup Europe* <http://www.gallup-europe.be/epm/epm_estonia.htm> (6 November 2003).

desire to emphasise nationhood to the fullest extent possible. The choice of words ('competence' instead of 'power' or 'jurisdiction') points in the same direction. But the strongest element for maintaining sovereign control is the requirement that transfers be limited to what is 'necessary' for carrying out treaty rights and obligations. The December 2002 amendments, which were thus intended to avoid the appearance of the inevitable reduction in sovereignty, highlighted changes of a technical nature,[14] sidestepping fundamental domestic constitutional issues, such as Community law supremacy and related problems of constitutional review discussed below. Absent clarification thus far of the Hungarian Constitutional Court's judicial review powers, the scope of the actual transfer of competences remains potentially subject to domestic constitutional control under the 'necessity clause.'

Both the early concerns of Estonia's legal elite and Hungary's shift towards a position of reservation about the supremacy of Union law represent strong national sovereignty concerns. In other countries of the region having similarly strong, historically embedded, concerns about independence and sovereignty, the concern over transferring competencies was much less explicit. Are the constitutional changes the governing elite's only attempts to disguise the fundamental change implicit in the general clauses enabling participation in treaty regimes? Is it a unique Central and Eastern European attitude, as implied somewhat condescendingly by certain Western Europeans? As it is implied, no reference is provided. After all, these countries are either entirely new entities or old ones having a history of nationhood under external threat of occupation. It should not therefore be surprising that the constitutions of the region, drafted after 1989, were manifestly keen on sovereignty and sovereign independence. None of this should be seen as a misplaced or otherwise excessive affirmation of national sovereignty. Notwithstanding rhetoric to the contrary,[15] no fundamental attachment to a constitutional value or principle of independence lies behind the accession amendments.

On the contrary, the various approaches to the transfer of competence visible in the various Europe clauses are essentially compatible with the prevailing continental constitutional solutions that emerged within the Member States in the post-Maastricht context — solutions which the accession countries took carefully into account in considering possible

[14] The Amendment provides for the mechanism of European elections and makes voting rights conform to EU law, enabling European 'citizens of other Member States who are residents in Hungary' to exercise active and passive voting rights in local elections. It also provides all EU Member State citizens and Hungarian citizens the right to participate in elections to the European Parliament. The election system is to be determined by qualified majority law and is currently subject to considerable horse-trading.

[15] For reason related to the dissolution of Czechoslovakia, at least one country, Slovakia did envision in her Constitution the participation in a 'state union', if approved by referendum.

constitutional solutions. The EU had in fact made it a priority to furnish the accession states the benefits of experience in this respect. Especially in view of continuing uncertainty over the nature of the Union itself including its identity, mission, and allocation of decision making powers,[16] at the very time the accession clauses were being written into the respective constitutions, some candidate states understandably hesitated to take a definitive position on the transfer of powers and competencies to the Union. Most of the Europe clauses reflect a degree of understandable caution. The Latvian clause, for example, expressly makes the accession subject to revision by way of popular referendum. Lithuania's amendment of Article 136 also contains a safeguard to the effect that the country's participation in international organisations is contingent on participation 'not contradict[ing] interests of the state and its independence,' even as the Europe clause expressly 'transfers to the EU the competencies of the national institutions in the fields foreseen in the Founding treaties of the EU, so that it shall be entitled to implement common competencies with other EU Member States in those fields.' The result of the referenda approved these drafts but formal amendment has not yet taken place. Article 79 of the Latvian Constitution states that:

> An amendment to the Constitution submitted for national referendum shall be deemed adopted if at least half of the electorate has voted in favour. A draft law decision regarding membership of Latvia in the European Union or substantial changes in the terms regarding such membership submitted for national referendum shall be deemed adopted if the number of voters is at least half of the number of electors as participated in the previous Saeima election and if the majority has voted in favour of the draft law, membership of Latvia in the European Union or substantial changes in the terms regarding such membership.

Referendum

Previously, in view of this abiding concern with independence and popular sovereignty, and due to the fundamental changes accession would bring, all of the Central and Eastern European accession states would have welcomed having accession (or the accession treaty) sanctioned by

[16] As of February 2003, Slovenia was at the beginning of the amendment procedure. Given the current text of the Constitution, it is inevitable that legislative and state powers be expressly transferred. According to press reports 'The bill on Slovenia's accession to the EU is to state that Slovenia wants to become a full-fledged member of this organization and is prepared to adopt and adhere to the EU's acquis. The country is willing to contribute to its formation in its future role of a Member State, the bill says.' 'Bills on NATO and EU Accession in Hands of MPs' *NATO* <http://nato.gov.si/eng/press-centre/press-releases/1854> (29 October 2003).

referendum. This was so even where such an expression of popular support was not required by the constitution, as had been the case in Hungary until the 2002 amendments. Indeed, some of the constitutions were amended precisely to include a requirement of confirmation by referendum. And it is true that adherents of popular sovereignty should welcome this position. But, with the significant exception of Lithuania,[17] the Central and Eastern European accession states (which do constitutionally and doctrinally endorse the position of popular sovereignty) have not since establishing democratic rule, shown keenness for referenda and plebiscites. There was not even a referendum in Czechoslovakia on the matter of dissolution of the state. Mobilising for a referendum has always been a problem because of the difficulties in achieving a quorum. Hungary barely satisfied the 50 per cent participation requirement in the case of the referendum on Hungarian NATO accession. All previous referenda in Slovakia, where the law on referenda requires, as in Hungary, a turn-out of over 50 per cent of all registered voters, ended unsuccessfully. Before the referendum on EU accession, there were five referenda held in Slovakia. All of them were unsuccessful due to low turnout.[18] Many previous attempts at holding a referendum were perceived by the political establishment as populist attempts to undermine the parliamentary constitutional order. (The potentially destabilising effects of referenda were dramatically illustrated in the power struggles between the Parliament and the President of Ukraine, and also in Moldova.)[19] It is quite telling that the Hungarian Constitutional Court, though in principle protective of the individual political right to referendum, systematically restricted the applicability of referenda, declaring various referendum initiatives to be disguised attempts at amending the Constitution. The Hungarian Constitution was in fact amended in 1997 to curtail the use of referenda as a device of change.[20] It is true that denying a right of popular initiative

[17] The Lithuanian constitution stresses the constitutional and constituent importance of referenda from the moment of its creation. Art 9.1 provides that a referendum be held on matters of fundamental importance affecting the population or the country. Note that the independence of Lithuania was restored through a 1991 referendum that was the culmination of mass resistance to Soviet rule.

[18] *SITA* <http://www.politika.host.sk/Prispevky/material_slovensko_sita_referendum.htm> (30 October 2003).

[19] For a review of the use of referenda see N Dorsen, M Rosenfeld, A Sajo and S Beer, *Comparative Constitutionalism* (St. Paul, West Group, 2003) 212-350.

[20] Ironically, the amendment that was adopted by the socialist-liberal coalition ruling at the time, which disposed of a parliamentary supermajority sufficient to constitutional amendment, is an obstacle today for the same coalition which currently has only a narrow majority. Because the socialist-liberal coalition restricted the use of referendum, they could not and will not be able to bypass the resistance of the opposition in accession matters by calling a referendum (where they probably would have a clear majority), and even the special one time referendum on accession required the consent of the opposition.

seems at odds with the theory of constituent power, but it is quite understandable in terms of constitutionalism and above all constitutional stability, a value that was considered absolutely crucial in the early formative years of the new democracies.

The above indicates that referendum was not a formal requirement of accession in the majority of Central and Eastern European accession countries. Nevertheless, the political elites in all Eastern European countries sensed, even without explicit discussion, that accession needed some form of popular endorsement. Even so, a referendum was not the preferred constitution-amending mechanism, especially in the case of these relatively easy-to-amend constitutions. Nor was referendum to become the tool of choice even after the recent round of amendments. In fact, in most countries (with Estonia and Latvia as somewhat ambiguous exceptions), the mechanisms expected to handle future constitutional amendments resulting from EU developments do not include the referendum. The governments' desire for popular legitimisation did produce occasional one-time solutions entailing referenda, but we need always to be cautious about exceptionalism in constitutional practices. Referenda were used as a plebiscitarian means for authorising accession. This approach required ad hoc legislation to provide the legal frame for such a one-time expression of popular will. Referendum remained outside the accepted regular means of constitutional politics.

And so a variety of plebiscite-like devices have been used. Hungary amended its constitution in order to be able to submit the question of EU accession to the Hungarian people by way of referendum. The amendment not only set the date for the referendum, but also the specific wording of the question to be answered: 'Do you agree that Hungary should become a member of the European Union?'[21] The amendment makes no reference, however, to the conditions of accession. This referendum was of course subject to the conditions of validity laid down in the 1997 amendments, and accordingly required that at least one quarter of the entire electorate 'gives the same answer.' Future amendments to the Hungarian Constitution arising out of EU membership are not made subject as such to referendum, but rather will be subject to the ordinary procedure of a two-thirds majority approval in Parliament of a text promulgating the amended Treaty. Technically, the Constitution will remain unchanged.

Estonia put to referendum a constitutional amendment that would itself authorise membership in the Union, 'in conformity with the basic principles of the Estonian constitution.' Future amendments to the accession authorisation will also be subject to referendum, so that any change in membership

[21] The opposition required the constitutionalisation, text and date of the referendum. Given the constitutional prohibition on constitutional amendments by referendum, the government that believed that it had to go via referendum had to make a compromise on the request.

conditions that would entail a divergence from Estonian constitutional principles would remain subject to referendum.

Under the Latvian Constitution (Article 68), issues of Latvian membership in the EU and future changes in that membership, are subject to referendum, if it is requested by at least one-half of the members of the Saeima (Latvian Parliament). Although in Latvia, constitutional amendments and referenda in general require that half of the entire electorate vote in favour of a proposal, referenda on EU-related matters require merely that (1) the number of votes cast is at least half of the number cast in the previous parliamentary elections, and (2) a majority of votes cast are in favour of the draft law.

Slovenia's position, like Slovakia's, was complicated by being tied to the referendum on NATO accession.[22] Under Slovenian law, a binding referendum may be called only if the law in question is pending in Parliament. Instead of changing the law, the government favoured holding a consultative referendum, while the opposition insisted on a binding referendum. The government having prevailed, the National Assembly called for a consultative referendum on NATO and EU accession which was held on 23 March, 2003.[23] In doing so, the National Assembly pledged to respect its outcome: 89.19 per cent voted for EU membership and 65.46 per cent for NATO membership.[24]

In November 2002, a felt need for legitimation via referendum prompted the Czech Parliament to enact a government-sponsored constitutional bill on referendum containing no quorum requirement. There had previously been no law on national referenda, though the practice of referendum did exist at the local level.

The story is similar in Poland where a referendum on EU membership was likewise not required by the Constitution. In the fall of 2002, the President initiated legislation that would require a referendum on the Polish accession. Theoretical considerations counselling against a referendum were not addressed, due to the dominance of traditional notions of sovereignty and an equally traditional equation between 'popular will' and 'direct participation.' In the accession referendum that took place in Poland on 7 and 8 June 2003, 77.45 per cent of voters said 'yes' to EU accession, 22.55 per cent said 'no'. Voter turnout was 58.85 per cent.[25]

The resort to referenda may well heighten expectations about the need for renewals of popular legitimacy on the occasion of future constitutional amendments and EU constitutional changes. On the other hand, the currently prevailing anti-referendum constitutional pattern seems, however,

[22] Above, n 16.
[23] <http://www.uvi.si/eng/new/press/data/press/2003-01-31_2003-01-31-103238.html> (10 February 2003).
[24] <http://www.rvk.si/rezultati-eu-nato/p4.htm> (3 November 2003).
[25] Pursuant to the report of 9 June 2003 of the National Electoral Commission: <http://www2.ukie.gov.pl/eng.nsf/0/D39E3D507607FEDAC1256D41002FEF52> (7 November 2003).

not to have changed. This is quite problematic in light of the losses in domestic democratic representation due to the progressive weakening of the national legislative branch discussed below. As shown by the 2002 Irish referendum, the availability of a referendum remains an important popular control device over executive activities. 'It is clear that retained powers of the people may force government to bring about greater domestic scrutiny of EU legislative proposals in advance of the referendum.'[26]

UNSETTLED CONSTITUTIONAL PROBLEMS

Supremacy of EU Law

Despite hesitations rooted in an insistence on the value of sovereignty reflected at a symbolic level in the Europe clauses, we observe a high degree of readiness to accept integration and the principle of supremacy of EU law. Slovenia adopted the following supremacy clause:

> Legal acts and decisions adopted within the framework of the supranational international organisation, to which Slovenia has transferred the exercise of parts of sovereign rights, shall apply in Slovenia in accordance with the legal requirements (legal order) of those organizations.[27]

There may have been scattered references to '*Solange*'[28] in the expert debates, but not outside them. Lithuania's political elite was even more 'blunt.' Notwithstanding Lithuania's commitment to sovereignty, the Parliament's working group proposed a Europe clause along the following lines (Article 136.4): 'The EU legal norms are an integral part of the legal system of Lithuania, and in case of collision they take precedence over laws and other legal norms of the Republic of Lithuania.' As of today, no constitutional amendment has been enacted. The drafters of the Polish Constitution likewise took a position in favour of the supremacy of EU law. Article 91(3) states that 'If an agreement, ratified by the Republic of Poland, establishing an international organization so provides, the laws established by it shall be applied directly and have precedence in the event of a conflict of laws.'[29]

[26] G Hogan, 'European Union Law and National Constitutions: Ireland' (FIDE XX Congress, London, <http://www.fide2002.org/pdfs/euireland.pdf> (12 November 2003)
[27] Art 3a of the Slovenian Constitution.
[28] *Solange Case I*., Federal Constitutional Court, Germany, BVerfGE 37, 271 (1974) and *Solange Case II*., Federal Constitutional Court, Germany, BVerfGE 73, 339 (1986).
[29] This is interpreted as a clear recognition of supremacy. See R Ludwikowski, 'Supreme Law or Basic Law? The Decline of the Concept of Constitutional Supremacy' (2001) 9 *Cardozo Journal of International and Comparative Law* 293.

The Czech Constitution, as amended in 2001, follows the Polish approach up to a point. International agreements, once ratified and approved by Parliament shall, if intended to bind the Czech Republic, constitute a part of the legal order, and take precedence over an existing Czech law with which it may come into conflict. International agreements are subject to constitutional review by the Constitutional Court, but only ex ante. While clear on the matter of treaty supremacy, the Czech Constitution does not indicate whether laws adopted under a treaty (eg, the secondary legislation of the EU) also prevail over a conflicting domestic provision.

In Hungary, the accession amendments deliberately avoided taking a position on the supremacy of EU law. The government's original draft did not squarely address the question, stating merely that community law and other 'achievements' [*sic*] of the European Union apply [are in force] in conformity with the founding treaties of the European Union and the legal principles that stem from the treaties.[30] The government's official explanation, however, unequivocally accepts the position of the European Court of Justice according to which national courts faced with a conflict must give preference to Community law over domestic law. The official comment referred to Article 249 TEU, thereby embracing the direct applicability of community rules, in conformity with the case law of the ECJ. The amendment was viewed as necessary for safeguarding the ECJ's exclusive jurisdiction over the interpretation of EU law, which is of course essential to Community law's uniform understanding.

The opposition in Parliament, as well as of the former prime minister (in various speeches outside Parliament), argued that such a measure would undermine the Hungarian Constitution and laws.[31] The German Constitutional Court's Maastricht decision offers an exemplary response to this opposition because even while acknowledging the presumptive primary nature of EU law, it provides sufficient protection to the national interest. While the veto power of the opposition prevented the proposed rule from being adopted, and notwithstanding the continued silence of the Constitution, the Maastricht decision nevertheless seems to represent the prevailing opinion. Reference is made neither to subsequent German court rulings such as the Bananenmarktordnung[32] nor to express supremacy provisions, found in Member State constitutions, such as that of Italy (Article 117).[33]

[30] Draft (No. T/1270.) on the amendment of the Constitution of the Republic of Hungary <http://www.mkogy.hu/irom37/1270/1270.htm> (12 November 2002).

[31] Of course, this is a complicated matter and Europe is in a flux with contradictory national views. See J Dutheil de la Rochere and I Pernice, 'European Union Law and National Constitutions' (2002) FIDE XX Congress, London <http://www.fide2002.org/pdfs/eurore-portgeneral.pdf> (12 November 2003).

[32] Federal Constitutional Court, Germany BVerfGE 102, 147 (2000).

[33] 'Legislative powers shall be vested in the State and the Regions in compliance with the Constitution and with the constraints deriving from EU legislation and international

Hungarian political actors thus tend to follow the strategy of what Stephen Holmes calls *gag rules*, ie a strategic decision to remain silent on a particular issue.[34] This is not an unreasonable strategy, for it is still unclear how the European system is going to develop. It also seems understandable from the perspective of day-to-day politics; it could prove politically too costly to raise the issue of supremacy of EU law in these countries with strong nationalistic sentiments and historical sovereignty reservations. On the other hand, too many gag rules will lessen the constitution's functionality and undermine its social relevance. Because the EU's future evolution will surely require the adoption of amendments or legislation by supermajorities, there is likely to be continuing political conflict over the measures that may be necessary to conform to Union law and policies. Consequently, what at this 'pre-dawn' moment is perceived as a green light to participation will, down the line, in practice become a green light to constitutionalised horse-trading and battles over turf between the government and the opposition.

Domestic Constitutional Review of EU Law

There are many current Member States whose constitutional courts, subject to the reservations set out in the German *Maastricht* and *Solange* decisions, do not generally enjoy review powers over the constitutionality of EU secondary legislation. However, in Central and Eastern Europe, the problem is not yet clearly settled, and is certainly not the case in Hungary where the Constitutional Court has carved out certain powers of judicial review of both international treaties and national legislation based on international treaties.

The Hungarian government understood the problem and sought to gain the upper hand through the supremacy clause discussed above. The government draft did not go so far as to expressly exclude the jurisdiction of the Constitutional Court (a step that perhaps would in any event be better taken by an Act of the Constitutional Court, rather than by the Constitution itself). The present situation, according to the Constitutional Court Act of 1989, is that the Court may review: (a) the constitutionality of provisions of international treaties, (b) the constitutionality of any legal norm after promulgation, and (c) conflicts between domestic law and international treaties. As to the constitutionality of treaty provisions, the Parliament, the President and the Government may initiate a challenge,

obligations.' Note that Italy, at least as far as the Italian Constitutional Court is concerned, is not considered to have given up national constitutional control over EU subject matters.

[34] S Holmes, *Passions and Constraint: On the Theory of Liberal Democracy* (Chicago, Chicago University Press, 1995) 204.

though *ex post* abstract review may be requested by anyone. Article 36 (1) of the Act XXXII of 1989 on the Constitutional Court states:

> Before confirming an international treaty, the Parliament, the President of the Republic and the Government may request the examination of the constitutionality of provisions of the international treaty thought to be of concern.

Article 21 (2) declares that 'The proceedings according to point b) of Article 1 (ex post examination for unconstitutionality of legal instruments) may be proposed by anyone'. Claims of conflict between domestic law and an international treaty may, in addition, be brought by any member of parliament, or raised *ex officio*.[35]

In 1996, a petition by a citizen to the Constitutional Court challenged the Europe Agreement and more specifically the direct applicability of Articles 85 and 86 (now Articles 81 and 82) of the EC Treaty claiming that 'by agreeing to directly apply the law of a foreign sovereign entity (the actual future form of which cannot even be influenced by Hungary), the Hungarian Republic unconstitutionally transferred part of its legislative powers to a foreign sovereign entity.'[36] The Hungarian Constitutional Court preliminarily ruled that it had the power to review the constitutionality of provisions of EU laws that become integral parts of the Hungarian legal system.[37] The question on the merits was

> whether the norms of the domestic law of another subject of international law, another independent system of public power and autonomous legal order [...] can be applied directly by the Hungarian Competition Authority [a regulatory agency], without these foreign norms of public law having [first] become part of Hungarian law.

[35] Art 21 (3) and (7) of the Act XXXII of 1989 on the Constitutional Court of Hungary.
[36] J Volkai, 'The Application of the Europe Agreement and European Law in Hungary: The Judgment of an Activist Constitutional Court on Activist Notions' (Jean Monnet Working Paper 8/99) 5 <http://www.jeanmonnetprogram.org/papers/99/990801.html> (11 March 2004).
[37] Case 4/1997 *AB. hat.* Constitutional Court of the Republic of Hungary (22 January 1997); The Hungarian Constitutional Court that is nowadays somewhat stereotypically labelled as the *par excellence* activist court (doing injustice to the Supreme Court of India), carved out a new jurisdiction for itself in the case. The law as it was at that time did not allow for *ex post* review of international treaties. The Court ruled that it has *ex post* review power not over the treaty, but rather over the national law that promulgates the treaty, as the promulgating law itself is just an ordinary law and the general rules of abstract review apply. However, the review of constitutionality does not directly extend to the international treaty itself. Later the Act on the Constitutional Court was amended to bring it into conformity with the Court's position. The *PIJ* decision ruled that its ruling does not affect the validity of Hungary's international obligations but it has to establish the conformity between the national system and the Constitution. In regard to Polish law, M Wyrzykowski above n 8, at 277 finds such interpretation 'an interpretation trick contrary to the principles of the constitutional state of law.'

The court found such application to be unconstitutional, although chiefly on the ground that Hungary was not yet a Member State.[38] Still the ruling may bar the direct application by Hungarian authority of certain rules adopted by the EU institutions, insofar as it questions whether the EU, through the Europe Agreement, has the power to directly determine the legal status of Hungarian legal persons. On the other hand, the Court made it clear that the problem might be resolved through an express constitutional authorisation for the transfer of powers. The Court's holding stated only that 'in an area of law under the exclusive jurisdiction of state sovereignty, the Parliament is not entitled to extend constitutionally over the principle of territoriality in an international treaty without express constitutional authorization.'[39]

In light of the Constitutional Court's ruling, the government took the position that a special amendment to the Constitution would be needed in order to preclude the Hungarian Constitutional Court's review of the conformity of Community law with the Hungarian Constitution. Since no such amendment was adopted, the possibility of review of EU law and its legislative implementation in Hungary subsists in principle. The 1998 ruling of the Hungarian Court is not in any event decisive. After all, on the basis of similar national supremacy rhetoric, other constitutional courts have managed to find ways of avoiding direct confrontation with EU law.

Constitutional Mechanisms Handling Future Amendments

Among the accession states, the standard position is that any future transfer of national competencies (or Treaty changes having such effect) requires parliamentary approval through legislation enacted with the same qualified majority that is required for a constitutional amendment. (Parliamentary majority might, however, be sufficient in the Czech Republic. On the other hand, Latvia's Constitution requires a referendum.)

[38] Case 30/1998 *AB. hat*. Constitutional Court of the Republic of Hungary (25 June 1998).

[39] It is not clear that the current power sharing (transfer of powers) provision that grants competencies to the Union under the accession treaty and the founding treatises satisfies the strict conditions of the Hungarian Court that stated that 'According to Art 2 (2) of the Constitution, the Parliament is the depository of the sovereignty of the people; the generally applicable form of the exercise of power is the exercise of power by the Parliament. [However,] ... the Parliament may not breach Art 2 (1) and (2) of the Constitution even by the conclusion and proclamation of international treaties. According to Art 19 (3) (a) of the Constitution, the Parliament has the competence to adopt and amend the Constitution. [Nevertheless,] also in this regard, the Parliament may only proceed constitutionally, in compliance with the procedural and decision-making requirements governing the amendment of the Constitution and on the basis of the provision on the direct and express power to amend the Constitution ... The Parliament is not entitled to carry out the covert amendment of the Constitution by means of the conclusion and proclamation of an international treaty.' *ibid*.

In light of the experience to date, however, we cannot rule out the possibility that special legislation on referenda will be used in the event of a fundamental structural change occurring in the Union, even if it is not at present constitutionally required. In other words, we can expect that future amendments to the EU treaty will continue to be a matter of ordinary consensual politics.

THE IMPACT ON DOMESTIC CONSTITUTIONAL STRUCTURES: A NEW SEPARATION OF POWERS

The most fundamental substantive and procedural changes in the constitutional systems, laws, institutions, and societies of Central and Eastern European countries will occur immediately following accession. Only at that moment will entirely new and different institutional mechanisms redefine the region in these respects. Most of the changes will not be reflected in the constitutions (except as a result of fundamental changes in the Union itself through the new constitutional framework emerging from the work of the Convention). However, they will be reflected in the interpretation of the constitutions and of the laws and institutions important to political practices. A major concern will be the specific impact that the constitutional amendments and future decision making arrangements will have on the separation of powers and on rights protection in the accession states.

The Czech and Hungarian constitutional amendments address the role of the legislative branch in the formulation of future European policies and legislation. The Hungarian provision on the matter, added to the amendment only upon strong criticism by the opposition and the government's junior coalition partner (the liberals), provides that in matters related to European integration, parliamentary 'supervision' and harmonisation between Parliament and government is to be determined by law adopted by a two thirds majority. It did not go so far, as has been urged, to provide that in matters to be regulated by statute according to the Constitution, the Government should participate in the decision making of the EU institutions 'in cognizance' of the national Parliament's position.

The Czech Constitution offers even less. It merely guarantees the possibility of an expression of parliamentary opinion that, though not without political importance, is not binding. The Lithuanian Parliament will have stronger powers:

> In order to guarantee the protection of the interests of the Republic and its participation in passing mandatory legal acts by the EU institutions, the Cabinet shall present to Parliament the conclusions on the proposals to pass such legal acts, and takes into account resolutions of the Parliament in the process of adopting.

It is true that taking into account the parliamentary position is not per se a guarantee of substantial parliamentary involvement, but, insofar as the draft describes the procedure 'as a protection of the interests of the Republic', the Lithuanian position reflects genuine concern over the importance of Parliament.

The notion of a consultative status for the national Parliament in EU decision making reflects the German model.[40] However, the German government is subject in general to more stringent control, due largely to the structure of joint decision making in certain federal areas. Under the German federal structure, state legislative bodies retain significant power, while the Bundesrat, composed of state government representatives, ensures representation of state national interests in the national parliament. Without these elements, an approach to parliamentary representative democracy based on parliamentary consultation may not be sufficient for Hungary or the Czech Republic.

In fact, after accession, the national powers of parliaments may diminish, while in some respects the powers of the executive will further increase. The emerging new division of powers takes away Parliament's legislative powers in matters that are of Union competence, while leaving unclear the scope of legislative powers relating to implementing legislation. The risk of parliamentary eclipse is especially marked in those Central and Eastern European countries where the matter is not even being discussed. But there is still hope. The Greek constitutional amendment of 2001 (Article 70, section 8) shows that the perception of a need for more effective parliamentary control or involvement may arise at a relatively late stage of the process.

The situation is aggravated by the fact that under the existing cabinet dictatorship model in most of these countries, the legislative branch was already weak to begin with. Thus, even the parliamentarians themselves were not deeply conscious of the need to secure the constitutional powers of parliament, and the idea of issuing binding instructions to the executive simply did not come up and would have been problematic if it had. However, the solution is not without precedent in Member States. German solutions provided the main points of reference, even though the more demanding Austrian solution (see Austrlian Constitution 23(e)) might have been considered, given the geographic proximity and the historical links

[40] Art 23 (3) of the Basic Law of Germany. The Government allows for statements of the Bundestag before it takes part in drafting European Union laws. The Government considers statements of the Bundestag during deliberations. Details are regulated by federal statute. This is the second time in recent history that the powers of the Hungarian executive were increased by simple reference to the German constitutional system (the first case was the introduction of the constructive vote of confidence in 1990). In both cases, the powers granted to the executive in Germany are balanced by the powers of the Länder, a factor that is missing in unitary Hungary.

between Austria and the Central and Eastern European region. Yet Austria, like Germany, is a federal state and an imperfect model insofar as federal states seem to have lost less of their national autonomy than unitary states within the EU.

It is true that most of the Central and Eastern European constitutions do provide that, in certain areas, legislation is exclusively reserved to Parliament.[41] But might the government not assert a power of implementation of EU law in these areas even without specific parliamentary delegation? Might not national implementing regulations be enacted that affect fundamental rights, even though the Constitution requires that fundamental rights be restricted, if at all, only by statute, possibly by qualified majority statute? All of this suggests that a certain weakening of checks and balances may well occur. The Czech system offers another example. Under Czech law, certain matters may only be regulated by 'constitutional law' (ie a law requiring supermajorities in both houses). Moreover, the Czech Senate has an important, albeit limited role, in ordinary legislation which historically has enabled the opposition to exercise a certain control over the majority, as well as over the government. This system may not continue to work. In Hungary, legislation affecting institutions and matters of fundamental rights required a supermajority in Parliament, which tended to force the government to search for solutions. This 'consociationalism' did not always work well, but it did create something of a barrier to government attempts to restrict rights. It may be that the overlap between legislation governing fundamental rights and legislation implementing European law is limited, but where it exists, a loss of an important domestic control may result. Finally, are constitutional courts going to strike down executive regulations that simply implement Community legislation, especially when, according to Community law the national constitutional courts cannot rule upon the validity of EU legislation? These are important practical problems, precisely because the Central and Eastern European accession countries have developed a robust system of constitutional review.

A lack of transparent popular representation may not be the best beginning for the people of the new Member States about to set foot on a common European path that is itself partially built on an unforeseen and uncharted form of European decision making, with less than full representation (or, to be more precise, with a new and complex representative system based on partial representation). The very representative element

[41] It is also possible that the implementation would require action by authorities that are without legislative power. This was the case in Hungary where the National Bank did not have regulatory powers that seem to be needed in the Euro system for a central bank to implement the European Central Bank's policies, or the national policies within that frame. The Hungarian Constitution was amended accordingly. Similar considerations came up in the mandate of the Slovenian 'Accession Drafting' Committee.

of the concept of the representative government is at stake. People are unlikely to feel compensated for this loss of representative democracy by direct elections to the European Parliament.

A progressive loss of importance of the national parliaments fits into an existing European trend that could well continue after the 2004 intergovernmental conference. Weiler refers to a 'flexible' Europe with a 'core' 'at its centre.' Such a Europe

> will actually enable that core to retain the present governance system dominated by the Council — the executive branch of the Member States — at the expense of the national parliamentary democracy. *Constitutionally, the statal structure would in fact enhance even further the democracy deficit*.[42]

In this scenario, the national legislative branches are the losers. Under the current constitutional arrangements, namely a lack of competence and a lack of information in Parliament, coupled with parliamentarians' inability to address issues before the Council, Parliaments will not even be able to defend the subsidiarity principle. By contrast, the national executive will be in a position to get policies enacted in the Council that the executive would not be able to get its own Parliament to enact, on account of public opinion, majority or coalition party interests, or supermajority requirements.[43]

To the extent that alternative forms of democracy are rather weak in Central Eastern European civil societies, the European 'democracy deficit' will find itself reproduced in different forms locally. The transfer of powers from national parliaments to the Council will reshape the fundamental power relations among the branches of government in the respective Member States without any public participation or even much public awareness of this development. One might argue that in the parliamentary systems prevailing in Eastern Europe, the separation of powers would not in any event offer much protection against abuse of power and is a weak surrogate for the working model of a robust democracy based on long-standing traditions and that there is thus not much to be lost in the process. However, the constitutional performance of these countries was surprisingly good in the last decade. Even if parliamentary representation and traditional checks and balances were weak, there were other sources of legitimacy, like government efficiency. Furthermore, democratic deficit concerns tend to be motivated by abstract principles of democratic

[42] JHH Weiler, 'Europe 2004 — Le Grand Debat: Setting the Agenda and Outlining the Options' (Brussels, Conference Paper 15 and 16 October 2001), see note 4 of Conclusion (Emphasis added).

[43] Consider, among others I Pernice, 'Der Parlamentarische Subsidiaritätsausschuss' (Berlin, Walter Hallstein — Institut für Europäisches Verfassungsrecht, 2002) (Paper 11/02). <http://www.whi-berlin.de/pernice-psa.htm> (30 October 2003).

representation, which may be misplaced in this context. After all, the existing parliaments have never had a decisive influence on the executive; they served more as transmission belts conveying the results of popular elections through the mechanism of forming governments.

From a constitutionalist perspective, and contrary to theoretical democratic perspectives, the new 'allocation of powers' is not objectionable per se. The likelihood of power concentration in a single hand is probably diminished (even if the power of the people is not automatically increased due to improved self-determination). Precisely because the constitutional amendments did *not* come about as a consequence of crisis, it should not be expected that more robust national Parliaments debating European issues will necessarily emerge. Nor can anything in the process be counted on to challenge the domination of the executive in the modern administrative welfare state. Constitutional safeguards of efficient governmental communication with parliaments or the people on pending EU decisions simply do not make a sufficient difference.

The often assumed connection between accession and democracy needs to be re-examined. It is true that European integration 'has been, historically, one of the principal means with which to consolidate democracy within and among several of the Member States, both old and new, with less than perfect historical democratic credentials.'[44] According to this record, accession should have a beneficial overall effect on the quality and strength of democracy as practiced in the new accession states. But the constitutionalisation of the accession process simply does not guarantee substantially greater constitutionalism overall. The whole process has been marked by 'ad hockery', with most steps in the accession process having been taken through quite ordinary and quite open horse trading between national oppositions and majorities. The choice by the political elites of Central and Eastern Europe of strategies based on accession referenda looks like a gamble, especially since referenda do not so much entail popular deliberation as a demonstration of loyalty via plebiscite. Judging by the Slovenian example, the resulting legal discourse is mostly about the expediency of the procedure. When political discourse is replaced by guesswork about quorum and majorities, the people are simply not being taken seriously.

The European integration of the accession countries might be a constitutional turning point, but it has generated neither genuine constituent power nor genuine enthusiasm. In sum, we have observed constitution making without a constitutional moment. Admittedly, the lack of constitutional dimension was and remains more or less characteristic of the existing 15 Member States. But, given the particular cultures of democracy in the Central

[44] Weiler above, n 42.

and Eastern European states, their lack of federal structures or of a strong civil society capable of checking the executive, and the erosion of possibilities for a *Verfassungspatriotismus*, European Union institutional arrangements will not easily fill the institutional vacuum that accession has created in this region.

References

Albi, A (2001) 'The Central and Eastern European Constitutional Amendment Process in Light of the Post-Maastricht Conceptual Discourse: Estonia and the Baltic States' 7 *European Public Law* 436.

Dorsen, N, Rosenfeld, M, Sajo, A, and Beer, A (2003) *Comparative Constitutionalism* (St Paul, West Group).

Habermas, J (2001) *So, Why Does Europe Need a Constitution?* (Florence, European University Institute).

Hogan, G (2002) *European Union Law and National Constitutions: Ireland* (London, FIDE XX Congress).

Holmes, S (1995) *Passions and Constraint: On the Theory of Liberal Democracy* (Chicago, Chicago University Press).

Ludwikowski, R (2001) 'Supreme Law Or Basic Law? The Decline of the Concept of Constitutional Supremacy' 9 *Cardozo Journal of International and Comparative Law* 293.

Pernice, I (2002) 'Der Parlamentarische Subsidiaritätsausschuss' *Walter Hallstein-Institut* (Berlin, WHI Paper 11/02).

de la Rochere, JD, and Pernice, I (2002) *European Union Law and National Constitutions* (London, FIDE XX Congress).

Varhelyi, O (2002) 'Hungary' in A Ott and K Inglis (eds), *Handbook on European Enlargement* (The Hague, TMC Asser Press).

Volkai, J (1999) 'The Application of the Europe Agreement and European Law in Hungary: The Judgment of an Activist Constitutional Court on Activist Notions' (Jean Monnet Working Paper no 8/99).

Weiler, JHH (2001) 'Europe 2004 — Le Grand Debat: Setting the Agenda and Outlining the Options' (Brussels, Conference Paper 15 and 16 October 2001).

Wyrzykowski, M (2000) 'European Clause: Is it a Threat to Sovereignty?' in M Wyrzykowski (ed), *Constitutional Cultures* (Warsaw, Institute of Public Affairs).

19

EU Accession in Light of Evolving Constitutionalism in Poland

MIROSŁAW WYRZYKOWSKI

THE CONSTITUTION MAKING process in Poland was lengthy. Poland was the first state of the former Soviet bloc to begin structural reforms (via the Round Table talks in the spring of 1989) and to amend its constitution (December 1989). These amendments were the starting point for work on a new constitution for a free, democratic state in which human rights are respected and a system of checks and balances prevails, having a social market economy, and giving ratified international agreements precedence over statutes. For various reasons, the preparation of the new constitution took a surprisingly long time. Some fundamental issues proved problematic, such as the model of government (a parliamentary-cabinet system vs. a presidential system); one or two houses of parliament; the role of local self-government and self-governments within professions; the extent of constitutional regulation of economic and financial issues; the position of human rights and liberties (in particular economic and social rights) in the state structure; and, particularly relevant for the present topic, the so-called accession option.

Focusing on the accession option, the constitution making process in Poland took place during a period of fundamental structural changes within the European Union. The context for the constitutional discussion was, on the one hand, the 1992 Association Agreement between Poland and the European Union, opening the road to negotiations for membership and, on the other hand, the Maastricht and Amsterdam Treaties. The authors of the constitutional drafts from 1990 to 1994 (both prepared by political parties and Parliament, and individual drafts prepared by legal academics) did not deal with the processes of Polish accession to the EU. A constitutional mechanism for Poland's membership in the EU was discussed for the first time in 1994, in the Constitutional Commission of the National Assembly. It was decided that the constitution should anticipate future events, especially as the future (ie accession) was drawing closer and closer. Hence the lively discussion on the place of the 'Europe clause' in the constitution, on

the principles and procedures of consent to membership in an international organisation, on the delegation of authority by the competent state organs to such organisations, and on the consequences of bringing EU law within the domestic legal order.

Poland's Sovereignty in Light of Accession

The most important point in discussions of the accession option was the issue of state sovereignty. It was first decided that state sovereignty should be emphasised and that the Europe clause should therefore not be included in Chapter 1, the section in which the state system was to be defined. During the first stage of discussions on the accession option, it was proposed that the option be recognised as a part of the state system. Thus, Poland could, by virtue of international agreements, delegate to international organisations or institutions certain competences of the organs of state authority. Poland would also respect all international agreements binding the European Union as well, as all laws passed by organisations of which Poland was a member. Those who supported the accession option as a component part of the state system had emphasised the aptness of placing the Europe clause in the first chapter of the constitution (the chapter dealing with the state system of the Republic of Poland), where its significance to the state structure would be made evident. Sceptics, however, argued that a society denied sovereignty in the 19th century and forced to accept limited sovereignty after 1945 should be sensitive to this issue, and that any hint of limited sovereignty within the part of the constitution defining the state structure should be avoided. A state that has only just recovered its sovereignty should not declare in its constitution readiness to lessen its sovereignty, not to mention to outright curtail it. In the end, the Europe clause was placed in Chapter 3, dealing with sources of law.

Article 90's Europe clause defines the constitutional conditions for Poland's membership in the European Union. It permits the Republic of Poland, by virtue of international agreements, to delegate to an international organisation or international institution the authority of the various organs of government in relation to certain matters. The content of the Europe clause and its place in the constitution's structure is a result of weighing a variety of political, systemic, historical and psychological arguments. It is also one of many examples of the constitutional compromise that enabled the National Assembly to pass, and later the nation to accept, the new Polish Constitution.

Supporters of EU accession pointed out that a constitutional provision determining the manner in which an agreement on Polish membership in the EU is to be ratified also supports the fundamental structural principle of national sovereignty (Article 4). By ratifying the Association Agreement in

1992, Poland made clear its aim to join the EU, thereby making it natural to define the constitutional conditions for membership. Moreover, as a clearly constitutional matter, these conditions are better regulated within the developing constitution than through what would be unavoidable constitutional amendments once Poland became an EU member. Yet a further argument was based on comparative law, namely the experience of EU Member States in amending their constitutions upon EU membership.

The most significant problem in relation to the Europe clause concerned the range, conditions, consequences and risks involved in delegating the competence of selected public institutions to EU institutions. Put simply, the debate concerned — and still concerns — the question of national sovereignty.

The first dimension of the debate over sovereignty relates to public international law. To begin with, some argue that dependence on another state limits or violates sovereignty. However, interdependence within international institutions that are created for common aims of Member States does not violate sovereignty. Delegating the competence of domestic public institutions to common international institutions may limit the exercise of sovereignty, but not sovereignty itself. Admittedly, the distinction between the concepts of 'limiting the exercise of sovereignty' and 'limiting sovereignty' is not a clear one. But the fact remains that membership in the EU does not affect the ability of Member States to discharge the obligations they have undertaken as independent and sovereign states. Significantly, Article 6 (3) of the TEU requires the EU to respect the national identity of its members and to ensure that EU Member States continue their existence as states in accordance with international law.

Second, this discussion about the essence of sovereignty in international legal theory and practice underscores the significance of Article 90 of the Polish Constitution, referring to the delegation of authority by state organs in relation to *certain matters*. The legislative history of the constitutional language does not reveal the precise intentions behind the concept. Article 90 does not clearly delimit either the type of competence delegated (ie only legislative) or the nature of the matters ('certain matters') over which delegation is permissible. At the same time, it clearly seems to prohibit the delegation of all the powers of any given public institution, for a public institution cannot exist without at least some specified powers. In short, Article 90 does not authorise the virtual closing down of a public institution by virtue of the delegation of the entirety of its authority to an international institution.

Thirdly, the range of competences delegated from selected public institutions of Poland to the EU will inevitably be known at the time of Poland's accession. They will necessarily encompass matters dealing with the European Union, including the repeal of barriers to the free flow of goods, persons, services and capital; a common trade policy; general rules of competition; common organisation of agricultural markets; protection

of fisheries resources; and significant aspects of transport policy. Fourthly, Poland, as a Member State, participates in the delegation of authority by decision making at the EU level. This mode of decision confirms the sovereign decision making role of Member States.

Ratification under the Polish Constitution

Discussion of the accession option (particularly the manner in which the decision to delegate the competences of public institutions over certain matters to the EU was to be ratified) was at the same time a discussion of constitutional procedure. The Polish Constitution provides a separate mode of authorisation for the President to ratify the agreement on Poland's membership in the EU. Article 90's Europe clause foresees that consent for ratification will be granted either by statute (Article 90 paragraph 2) or by referendum (Article 90 paragraph 3). Both of these modes represent vehicles by which Poland could delegate the authority of its public institutions in certain matters to international organisations.

Thus, the constitution allows for alternative modes of authorising the President to ratify international agreements. The decision as to the mode of consent to be used for ratification is the first decision in this process to be made by the Sejm (the lower house of the parliament). This is a choice between indirect democracy, in the form of legislation, and direct democracy, in the form of a referendum. The strictly complementary role of the latter is beyond doubt. First of all, the results of the various referenda organised as a form of binding expression of the will of the people should make the state's decision makers extremely cautious. Secondly, an analysis of the level of political legitimacy measured by both parliamentary election results and measured by a referendum may lead to surprising results.

Before commenting on a referendum as a form of consent for ratifying the agreement on Poland's EU membership, I shall look at the ratification statute as provided for by Article 90 paragraph 2, of the Polish Constitution. Under this provision, the Sejm must enact such a statute by a two-thirds majority vote with at least half of the statutory number of deputies present and voting. The same applies to the Senate. By contrast, an 'ordinary' statute needs only a simple majority vote with at least half of the statutory number of deputies present and voting. Once again, the same applies to the Senate (Articles 120 and 124). An 'ordinary' statute is also used for ratifying other types of agreements, such as those listed in Article 89:

> (1) peace, alliances, political or military treaties; (2) agreements on freedoms, rights or obligations of citizens, as specified in the Constitution; (3) the Republic of Poland's membership in an international organisation; (4) agreements resulting in considerable financial responsibilities imposed on the State;

> and (5) agreements on matters regulated by statute or those in respect of which the Constitution requires the form of a statute.

Even a brief look at the agreement on Poland's membership in the European Union reveals that this agreement corresponds to all five of the categories of international agreements mentioned in Article 89. The one element that sets this agreement apart from these categories of international agreements is that it calls for the delegation of authority by public institutions to international organisations or institutions.

As noted, in order to enact a ratification statute that is subject to Article 90 paragraph 2, both the Sejm and the Senate must do so by a two-thirds majority, with at least half of the statutory number of members of each house of Parliament present and voting. In the Sejm, this is the same majority that is required for any statute amending the constitution. In the Senate, however, the two-thirds majority that is needed for a ratification statute under Article 90 is a higher majority than is required for a statute amending the constitution. In the latter case, an absolute majority vote alone is required. Thus, choosing the parliamentary mode for granting consent for the ratification of Poland's membership in the EU would mean choosing a mode that leaves not the slightest doubt concerning the political legitimacy of Parliament's decision.

Achieving a two-thirds majority vote in Parliament will require the parliamentary majority to work together with the opposition. In no parliament since 1989 has there been a majority ruling coalition enjoying the luxury of reaching a two-thirds majority. Moreover, both governments ruling under the new constitution since 1997 have had difficulty maintaining a coalition. Thus, the government must gain the votes of the opposition in order to pass a ratification statute. The authors of the constitution rightly understood that the decision to join the European Union was a matter of statehood, and that decision should therefore have to be made by a qualified majority of parliament. This means that from the moment that the constitution entered into force until the ratification of the agreement on EU membership, both the parliamentary majority and the opposition are both constitutionally and politically obliged to cooperate in order to reach agreement on Poland's membership in the EU. In effect, the matter of Poland's membership in the EU has to be excluded from all other political issues debated between the ruling parties and the opposition in parliament.

The need to seek a 'ratification coalition' is somewhat less true of the Senate, due to its electoral system. Under the Senate's majority electoral (as opposed to proportional) system, we can observe in the Senate a 'raised scale effect,' meaning that in the Senate there is an over-representation of representatives of political parties which form the parliamentary-cabinet majority in the Sejm. Hence, it is all but certain that a 'ratification coalition' in the Sejm will be replicated in the Senate. During the current parliament's

term, the initial parliamentary-cabinet majority in the Sejm had a majority in the Senate exceeding that needed to ratify Poland's EU membership — a qualified majority of three-quarters of the Senate.

Thus, there is no doubt that a ratification statute would have greater political legitimacy than any other legal act passed by parliament. A requirement of this level of political legitimacy within the Polish Constitution is understandable considering the obvious, and even less than obvious, consequences of ratification of the agreement on Poland's membership in the EU. Here, I am referring especially to the effects of the EU legal order on the Member State's legal system as well as on the competences of certain state institutions. The acceptance of the *acquis communautaire* is tantamount to a revolution in the domestic legal order, due above all to the magnitude of change introduced to the domestic legal order and the possible negative consequences of this acceptance. In order to lessen the blow of this revolution, the changes are being introduced over several years through a process of gradually adapting domestic law to EU law. No state has experienced greater changes in every sphere of public life than those necessitated by membership in the EU. The level of legitimacy required for the decision is a function of the scale of changes that EU membership entails.

Polish Domestic Law and EU Law: Avoiding Conflicts

The range of competences delegated to the European Union, as compared with the range of competences retained by the domestic institutions, is one of the aspects of the question of sovereignty, viewed both from the perspective of international public law (external sovereignty) and from the perspective of constitutional law (internal sovereignty). Polish membership in the European Union may produce still more dramatic change in the event of an irreconcilable conflict between EU law and the Polish Constitution. This is especially due to Article 8 paragraph 1 of the Constitution, according to which 'The Constitution shall be the supreme law of the Republic of Poland,' on the one hand, and the principle that European Union law takes precedence over domestic law, on the other. It is especially important to resolve such conflicts so as to avoid a situation in which a choice has to be made between respecting the national constitution and respecting EU law.

In fact, the consistency between certain constitutional norms with EU law is subject to question. A first problem is the right of EU citizens to vote in local elections and elections to the European Parliament (Article 19, paragraph 1 of the ECT). According to the Polish Constitution:

> A Polish citizen shall have the right to participate in a referendum and the right to vote for the President of Poland as well as representatives to the Sejm

> and Senate and organs of local self-government if, no later than on the day of vote, he has attained 18 years of age (Article 62, paragraph 1).

As written, this article does not address the participation of EU citizens in local elections. It may therefore be interpreted as not excluding that possibility, but simply leaving the details to regulation by statute. As for elections to the European Parliament, this matter is simply not regulated at all in the Constitution. Such friendly interpretations of the constitutional norm would serve to maintain the constitutional guarantee of political rights for Polish citizens, while permitting an application to other EU nationals that is fully respectful of EU law.

Of course there can be no doubt about the Polish Supreme Court's authority to decide on the validity of elections to the European Parliament. But questions surround this issue as well. For example, may electoral rights not regulated in the Constitution be regulated by simple statute? After all, the Constitution sets out precisely the situations in which the Supreme Court shall decide on the validity of elections and referenda. It may be necessary to expand this clause so as to extend the existing competence of the court to analogous matters arising directly out of Polish membership in the EU. This would ensure respect for the fundamental principle that the competence of public institutions may not be presumed.

The Polish Constitution confers a variety of social rights, such as the right to social insurance in case of illness, the right of access to health care services financed from public funds, and the right of free and equal access to public education. Any limitation of these rights to Polish citizens would be incompatible with Article 39 of the ECT establishing the free movement of workers as one of the four fundamental freedoms, and prohibiting discrimination based on citizenship within the scope of the Treaty. These examples show the need to adapt the Polish Constitution to EU law. Ideally, all constitutional provisions that are clearly incompatible with EU law would be eliminated to ensure that non-Polish EU citizens would have the same rights and liberties as Poles. One possibility would be to add to each relevant constitutional norm in the Polish Constitution a clause expressly extending the rights in question to all EU citizens, as required by EU law. Conceivably, it would even suffice to regulate these matters by statute, without amending the constitution. It may also be useful for the Polish Constitutional Tribunal to embrace the notion of a presumption of silent modification of the constitution by all EU legal norms, although it is questionable whether that would be satisfactory to the European Court of Justice.

It may also be necessary to amend the constitutional provision (Article 92) governing the right of Polish courts to refer questions to the Constitutional Tribunal on the conformity of a normative act to the Constitution, to ratified international agreements or to national statutes,

where the referring court needs an answer to that question. When the question of interpretation or validity relates to EU law, the Constitutional Tribunal is not of course the court to be addressed, but rather the European Court of Justice. Should a Polish court happen to refer such a question to the Constitutional Tribunal, Article 192 of the Constitution, as it stands, would justify the Constitutional Tribunal in instructing the court to refer the question instead to the ECJ.

Retaining Poland's National Identity

Political responses to the agreement on Polish accession to the EU reveal an even more difficult problem relating to state sovereignty. A discourse of 'national identity' has arisen both in parliamentary debates and in solemn declarations of the Polish government. National politicians are championing Poland's right to decide for itself on controversial public issues, some of which, like the issues of abortion and same-sex marriage, are particularly important to the Catholic Church and to Poland's nationalist-catholic parties. Under the Constitution of 1952, which did not contain an express guarantee of the 'protection of life,' the Polish government succeeded in securing the enactment of a restrictive abortion law permitting abortion only in the case of danger to the mother's life; even rape was not a sufficient justification. The Constitutional Tribunal, to which the constitutionality of this statute referred, upheld the statute's constitutionality on the basis of a right to life running from the moment of conception, though subject to significant dissenting opinions.

Another controversial issue is the legality of same-sex marriages. During the last phase of preparatory work on the Constitution, in deference to the Catholic Church and other extra-parliamentary forces, express reference was made to the protection of marriage. Article 18 of the Constitution states that 'Marriage, defined as a union of a man and a woman, as well as the family, motherhood and parenthood, shall be placed under the protection and care of the Republic of Poland.' For its supporters, this clause means not only that the state has a role in the protection and care of marriage, defined as a union of a man and a woman, but also that a legal partnership between people of the same sex is prohibited. Others, however, maintain that an obligation to protect and care for marriage cannot be interpreted as prohibiting of the legal regularisation of unions between two people taking forms other than marriage, but nevertheless having private law and public law consequences.

These two issues were the subject of lively public discussion in the shadows of the accession debate and preparation of the referendum authorising the President to ratify the agreement on Poland's membership in the EU. The government was not eager to discuss these topics publicly, particularly

abortion, for fear of a strongly negative reaction by the Catholic Church, which has a powerful influence over public opinion.

The Use of Referenda

As noted, an alternative to the legislative procedure for granting consent for ratification is a nationwide referendum (Article 90, Part 3). The referendum procedure represents an important instrument of direct democracy. The referendum procedure has already been used in other countries for ratifying agreements on accession to the Union. For example, it has been used successfully in France and Denmark, and unsuccessfully in Norway.

The choice of a referendum is not made until after the government has presented a ratification statute. Once the referendum procedure is chosen, the legislative procedure is excluded. The Sejm alone makes the choice of procedure, acting by an absolute majority of votes in the presence of a quorum of at least half of the number of deputies. The general provision authorising the President to call a nationwide referendum upon consent of the Senate does not apply to the EU referendum.

Where the referendum procedure is adopted, the constitutional and statutory provisions relating to referenda become applicable. In order for a referendum to be considered a binding one, more than half of those having the right to vote must take part in it. If less than half of those having the right to vote take part, the results of the referendum will not be binding. This would also signify the end of the proceedings for authorisation of the President to ratify the international agreement through this procedure. However, this would not mean that the issue of ratification is necessarily over. The question that would arise in such a case is whether resort can then be had to the procedure of a ratification statute. This question is discussed below.

If more than half of those having the right to vote participate in the referendum, and a majority of those taking part vote in favour of ratification of the accession agreement, then, once the Supreme Court has declared the referendum to be valid, the President is obliged to ratify the agreement. He could still, however, exercise his right to make a referral to the Constitutional Tribunal on the conformity of the international agreement with the Constitution. If the Constitutional Tribunal finds the agreement to be consistent with the Constitution, the President is then obligated to ratify it. If more than half of those having the right to vote participate in the referendum, and a majority of those taking part vote against ratification of the agreement, then, once the Supreme Court declares the referendum to be valid, the President may not ratify the agreement.

But it may also happen that less than half of those having the right to vote take part in the referendum. If so, and assuming the referendum is

declared valid, the results are not binding upon the President. Where, in such a case, the majority of those voting opposes ratification, there is obviously no consent to ratification. But it may happen that, in a referendum in which less than half of those having the right to vote take part, the majority votes in favour of accession. The question then arises whether a condition for granting consent to ratification is the binding character of the referendum, ie whether a turnout of over half of those having the right to vote is necessary for consent to ratification. The better view would be that a majority of those taking part in a binding referendum must have voted in favour of the ratification. This is consistent with the view that where the procedure of ratification by statute is used, particularly strict requirements as to the level of legitimation apply. There is no good reason for lowering the legitimation requirements when the referendum procedure is used instead.

Let us consider the issue of legitimation more closely. In the case of a ratification statute, as we have seen, the level of legitimation is even higher than in the case of a constitutional amendment (although a referendum is also required on the issue of sovereignty as defined by Chapter 1 of the Constitution). Thus, the level of legitimation is as high as it can be for any statute. Under the electoral ordinance currently in force, based on proportional representation, Parliament is fully in a position to express its consent in a ratification statute. At the same time, the requirement of a qualified majority, namely two-thirds of votes in both the Sejm and the Senate, for the adoption of such a statute, makes it necessary to assemble a large parliamentary coalition. Whichever political parties happen to form the majority at the time of the ratification procedure, we may assume that either a large coalition will have been created (possibly including the opposition parties), or else the statute will not be adopted. This constitution should also determine the behaviour of any parliamentary majority towards the opposition so that the rules of conduct in the European integration process should also be common to all major political forces in the State (*compromesso storico* of the parliamentary majority and opposition concerning the issue of the European integration). Otherwise, it could be a programmed defeat in the most important matter since the creation in 1989 of a democratic state of law based on the principles of market economy.

Without attempting a detailed analysis, let us examine the arguments advanced by the supporters of referendum. They emphasise that referendum is the most important form of direct democracy and therefore represents an especially effective expression of the principle of natural sovereignty. As such, it may be considered as an important complement to the mechanisms of representative democracy. As we can learn from the experiences of countries where this means of expressing popular will is commonly used, the referendum may operate as a kind of safety-valve, a strong warning sign to the parliament in periods between parliamentary elections. Viewed from a pragmatic political point of view, the referendum serves to strengthen the legitimacy of decisions that are made during those periods.

On the other hand, sceptics about referenda point out that, in practice, this instrument is usually wielded by interests which, while declaring their faith in the collective judgment of the society, in fact already know from public opinion polls that the position they support enjoys a very good chance of winning. To that extent, the referendum, paradoxically, may be seen not so much as complementing, but actually as weakening the notion of representative democracy which, at least in its modern version, consists in entrusting authority to the people whom the electors have, for whatever reasons, chosen to represent them in the parliament for a period of years. Thus, working democracy does not mean that all of society determines the outcome of individual daily decisions, but rather at most that the elite groups which have been authorised to make those decisions will have to canvass the population for political support. This reflects Giovanni Sartori's claim that democracy is a system in which society acts as arbiter in the contest for power waged by politically organised elite groups.

Moreover, representative democracy provides certain guarantees that referenda simply do not offer, in particular, procedural guarantees of negotiation and compromise. Basically, referenda create the possibility of making a decision, typically in the form of a choice between disjunctive alternatives. Considering the additional fact that matters submitted to referendum typically provoke strong emotions, we face the real possibility that irrational decisions will be made. Add to this the generally low level of political activity in society, confirmed by turnout at elections. Even in a polarising election such as the presidential election of 1995, participation did not exceed 42 per cent, although this kind of referendum did not require 50 per cent to have a binding effect.

It remains highly probable that, at the end of the day, a referendum will operate as a kind of expensive public opinion poll, revealing the general preferences of the society, but without earning a binding character due to insufficient turnout. Even if a majority votes in favour of a membership, the referendum may therefore be non-binding. Parliament will be even more reticent, if the result of referendum is negative, even where, due to insufficient turnout, the referendum is not binding.

CONCLUSIONS

First, and most obviously, there is need for more discussion of the essence of sovereignty in the Republic of Poland. The starting point for such a discussion must be determined by reason and not emotions, by a precise contemporary understanding of the notion of sovereignty and not general suppositions rooted in the past. False premises about the nature of sovereignty may produce consequences that are contrary to those that are intended, with the result, not of an expansion of Polish sovereignty within the family of sovereign states organised within a supranational structure,

but rather of tangled internal disputes without useful outcomes. There is also the related risk, which must be avoided at all costs, that a negative referendum will result in a nation's self-marginalisation within European politics and society.

Second, and contrary to the claims of those who oppose integration into the European Union, not only do constitutional provisions on accession not limit sovereignty, but they establish the premises for protecting sovereignty's essence. By opening up procedural possibilities for ratifying fundamental decisions concerning Poland's fate, these constitutional provisions guarantee that Polish integration will occur only if a qualified majority supports it, and that no integration decision will be made that could give rise to serious doubts concerning the Polish reasoning of existence.

Third, the Europe clause has far more to do with matters of internal sovereignty than would appear from the constitutional discussions that have taken place. Regardless of the procedure that is chosen for granting authorisation to ratify the accession agreement, it will have been one that implies a constitutional imperative of cooperation between the parliamentary majority and the opposition.

The Constitution does not expressly address the possibility of resorting to the procedure of parliamentary authorisation in the event that a referendum is held, but the results are not binding. The Parliament eventually regulated this issue by an Act of 8 March 2003, whose Article 75 provides that if a referendum turns out not to be binding, the Sejm may once again freely make a choice between procedures for authorising the President to ratify the agreement.

This provision, like many others, was the subject of a constitutional challenge by a group of deputies. According to the claim, the provision infringed Article 4 of the Constitution, because

> [...] referring a matter to a direct decision of the Nation means referring it to a power supreme in relation to the parliament, so it is impossible to change the decision of the supreme power by a parliamentary decision. But there are two preconditions that must be met jointly for such a decision to be taken by the Nation: firstly, more than half of those having the right to vote must participate in the referendum, and secondly, the majority of participants must support one of the solutions.

The logic of the challenge is that Parliament may not constitutionally change a decision that has been taken by the supreme power, namely the people. But this logic in turn rests on an assumption that a referendum reflects such a 'decision' even when it does not have a binding character. But one can hardly speak of a 'decision', in the sense of a final and conclusive resolution, when the Constitution itself prescribes special conditions for a 'binding resolution', which even the claimants acknowledge as being 'essential'.

The Constitutional Tribunal (Case K. 11/03) rejected the claim that, in the above situation, 'the decision of the supreme power is changed'.[1] For that to occur, both prerequisites for 'taking a decision' must be fulfilled: participation of more than a half of those having the right to vote and support of the majority of participants for one of the solutions. The Tribunal did not accept the applicants' argument that '[…] each lack of resolution is a negative answer by the supreme power — the Nation — to the proposition of ratifying an international agreement which produces the results specified in Article 90 of the Polish Constitution.'

The Tribunal emphasised that the choice between the statutory and referendum procedures is a choice between implementing the principle of sovereignty of the nation through representative democracy or through direct democracy. The basic or primary form of consent to ratify an international agreement is the procedure that entails action by state authorities, ie the statutory procedure. This is also the more 'special' procedure, reserved exclusively for this kind of agreement. The referendum represents an alternative procedure, entirely optional, for securing consent to ratification of such an agreement — its optional character being reflected in the use of the modal verb 'may', as well as by the structure of Article 90 itself.

The Constitutional Tribunal found further support for its position in the supplementary character of the referendum in the Polish legal system. One cannot speak of a citizen's basic right to referendum because a citizen or group of citizens simply has no legal right to initiate the measures which lead directly to the holding of a referendum. A civil right to referendum is in fact rare in European constitutions. The constitutions of Slovenia (requiring a motion by 40,000 electors), Slovakia (requiring a motion by 350,000 electors), Lithuania (requiring a motion by 300,000 electors), Italy (requires a motion by 500,000 electors or 5 regional councils) and Switzerland (requiring a motion by 50,000 electors or 8 cantons) all illustrate the point.

According to the Tribunal, 'granting consent' occurs when more than 50 per cent of those having the right to vote participate in a referendum and the majority of participants in the referendum vote for the proposed resolution. 'Not granting consent,' on the other hand, occurs when more than 50 per cent of those having the right to vote participate in a referendum and the majority of participants in the referendum vote against the proposed resolution. Only in these two situations may one properly conceive of the result of the referendum voting as having a decisive character in relation to the subject-matter of the referendum.

The Constitutional Tribunal understood Article 90 of the Constitution, properly construed, as permitting a 'reserve' procedure in the event that, upon conclusion of the procedure originally selected by the Sejm, the entity

[1] Poland's Constitutional Tribunal, Case K 11/03.

authorised to give its consent under the procedure chosen gives no conclusive opinion. The Tribunal deduced this result from the principle according to which the Constitution should not assume the occurrence of a situation that would produce a constitutional 'stalemate'. This would be unacceptable from the point of view of constitutional order and, should it ever occur, would necessitate an appropriate constitutional amendment. Thus, if the result of a referendum turns out inconclusive, it remains entirely permissible to use the 'reserve' procedure of obtaining consent for ratification by means of a statute pursuant to Article 90 paragraph 2 of the Constitution. The referendum can have no greater weight than that of a suggestion.

The Tribunal is thus correct in rejecting the idea that the sovereign cannot take a decision through its representatives after failing to take that decision through an exercise of direct democracy. This is all the more so because the representatives in question had been elected in a parliamentary election which everyone had understood might be called upon to decide the issue of Poland's membership in the European Union. The people elected as representatives in the parliamentary elections to the Sejm and the Senate for the current term of office are persons who, it could be expected, would take the decisions relating to Poland's membership in the EU.

Finally, according to the complaint, Article 235 of the Polish Constitution, which is the constitutional amendment procedure, was also infringed insofar as the challenged statute introduced a new stage in the procedure for ratifying an international agreement, thereby effectively amending the relevant constitutional provisions. In the view of the Tribunal, however, the Referendum Act neither amends the Constitution nor introduces 'amendments to the Constitution' or 'amendments to constitutional provisions.'

On 7–8 June 2003, the European referendum was held. The number of participants reached 58.85 per cent of all those having the right to vote, well over the threshold. Of those casting votes, 77.45 per cent favoured Poland's membership in the European Union, with 22.55 per cent of participants opposing it — again well above the threshold. The result of the referendum was both binding and favourable. The President of the Republic then ratified the agreement on Poland's accession to the European Union.

20

Contested Norms in the Process of EU Enlargement: Non-Discrimination and Minority Rights

ANTJE WIENER AND GUIDO SCHWELLNUS

INTRODUCTION[1]

EUROPEAN ACCESSION NEGOTIATIONS and compliance with the accession criteria[2] proceed in accordance with 'treaty language.'[3] While the candidates' interest in EU membership counts as a strong motivation for compliance, to be sure, ultimately compliance depends on the perception of legitimate procedure, that is, on the principle of 'right process.'[4] How to ensure compliance thus takes precedence over what substantive conditions to impose. The actual substance of European Union law, including the *acquis communautaire* as the institutional framework, the political objectives, the administrative procedures and the entire body of law which form the EU's formal and informal institutional properties, is therefore

[1] Earlier versions of different parts of this chapter were presented at a number of academic conferences, including the workshop on 'Law and Governance in an Enlarged Europe,' Columbia University, New York City, 4–5 April, 2003; the Annual Meeting of the International Studies Association, New Orleans, 24–27 March 2002; the ECPR Joint Workshop Sessions, Turin, Workshop 4: 'Enlargement and European Governance,' 22–27 March 2002; the Young Scholars 2002 Conference, Prague, 29–31 May 2002, as well as the UACES Annual Conference, Belfast, 2–4 September 2002. For comments we would like to thank the participants at these events. Special thanks go to George Bermann, Katharina Pistor, Joanne Scott and Theresa Wobbe. Responsibility for this version is ours alone.

[2] Dubbed 'Copenhagen criteria' with reference to the place where they had been agreed in 1993. For details of the accession criteria which were defined at the 1993 Copenhagen conference, see the Commission website at <http://europa.eu.int/scadplus/leg/en/lvb/e40001.htm> (19 February 2004).

[3] A Chayes and A Handler Chayes, *The New Sovereignty. Compliance with International Regulatory Regimes* (Cambridge and London, Harvard University Press, 1995).

[4] T Franck, *Fairness in International Law and Institutions* (Oxford, Clarendon Press, 1995) 24.

not the yardstick.[5] Yet, it is this body of law which the candidate countries have to respect upon accession as full members in 2004. The entire *acquis communautaire* must be accepted 'as binding' by all members.[6] For candidates, this is a 'compulsory and demanding reference framework.'[7]

Enlargement thus entails a twofold adaptation to externally defined rules and norms for the candidate countries. First, they are expected to adopt at least a modicum of new legal, political, economic and administrative standards — the accession criteria — in their respective domestic polities. This process involves mainly formal institutional adaptation, thus establishing the legal validity of the accession conditions in the domestic context of each candidate country. Such adaptation has been monitored by the European Commission and documented in accession reports.[8]

The second type of adaptation arises more clearly after accession. It involves implementing the new rules, norms and principles in political and legal performances. At this point, the interpretation of norms, principles and procedures, as it has evolved over five decades of constitutionalisation within the EU, becomes vital for the member states.[9] This second period is distinctive for its constitutional quality, for it includes transposing the EU's *acquis* into domestic contexts, which in turn sheds light on the political and cultural validity of such basic European norms as supremacy, direct effect and subsidiarity in the respective domestic context of each new member states.

The present inquiry raises questions about the legitimate underpinning of the EU enlargement process. To that end, it highlights the policy and politics of enlargement with reference to the development of two norms included in the accession criteria of the European Union: non-discrimination and special minority rights. Both norms pertain to the protection of minorities, a concern which acquired an immensely important role in the Union's external relations after the end of the Cold War and was reflected in the

[5] The *acquis communautaire*, or short 'the acquis' is a contested concept albeit the frequent references in different contexts. It has become a standard reference, a kind of compliance yardstick for candidate countries. According to the TEU, art 2(1) the Union is 'to maintain in full the *acquis communautaire* and to build on it.' For a detailed discussion about the concept's application and use in the literature, see C Delcourt, 'The *acquis communautaire*: Has the Concept Had Its Day?' (2001) 38 *Common Market Law Review* 829–870.

[6] Case C-259/95 *Parliament v Council* [1997] ECR I-5313, para 17, cf C Delcourt, above n 5, 830.

[7] C Delcourt, above n 5, 831; C Gialdino 'Some Reflections on the *acquis communautaire*' (1995) 32 *Common Market Law Review* 1089–1121; A Michalski and H Wallace, *The European Community: The Challenge of Enlargement* (London, Royal Institute of International Affairs, 1992).

[8] H Grabbe and K Hughes, *Enlarging the EU Eastwards* (London, The Royal Institute of International Affairs, 1998); H Grabbe 'How does Europeanization affect CEE governance? Conditionality, diffusion and diversity' (2001) 8(6) *Journal of European Public Policy* 1013–1031.

[9] Regardless of the type of constitutional text that stands to be agreed as the result of the 2003–04 constitutional process, the EU's treaties are the result of five decades of constitutionalisation.

political accession criteria spelled out at the Copenhagen European Council in 1993. However, while the meaning of the principle of equality and non-discrimination as a cornerstone of individual human rights is sufficiently defined internationally and institutionalised on the EU level, minority protection although generally accepted as desirable after the Cold War, remains deeply contested in its meaning on the international level and has been largely absent from the EU's *acquis communautaire*. Among the political accession criteria, 'the insistence on genuine minority protection is clearly the odd one out. Respect for democracy, the rule of law and human rights have been recognised as fundamental values of the European Union's internal development *and* for the purpose of its enlargement, whereas minority protection is *only* mentioned in the latter context.'[10]

By scrutinising minority protection as a contested norm in the EU enlargement process, this chapter contributes to research on the development of international norms. It contests the assumption that international norms have to be 'robust' in order to have impact and can therefore be treated as stable structural factors with fixed and clear meaning. To that extent, it problematises the meaning of particular norm types. To demonstrate the variation in meanings of specific norms types, we first trace different interpretations and path dependent developments based on a reconstruction of the meaning of regional and global norms. Secondly, we identify the role of different domestic meanings of norms in the course of rule-adoption by applicant states. We argue that, although EU conditionality may induce compliance, the contestation of minority rights implies the possibility of unintended long-term effects in the applicant countries, as well as a potential backlash against the EU after accession.

The remainder of the chapter proceeds in four parts. In the first part, we situate the subject within the recent international relations literature on norms, developing the theoretical argument of path dependent norm construction and norm resonance. In the second part, we establish the content of the norms of non-discrimination and special minority rights in the international and European context, and elaborate on their internal institutionalisation and external promotion by the EU, with a special focus on the conceptual tensions between the articulation of minority protection norms in these different contexts. In part three, we offer a comparative account of norm diffusion and domestic norm construction in the case of three applicant countries: Romania, Hungary and Poland. Finally, the conclusion reflects on the long-term feedback effects of the tension between the EU's internal non-discrimination policy with regard to minority protection, on the one hand, and domestic norm construction in applicant countries, on the other — a tension which flows from the

[10] B De Witte, 'Politics Versus Law in the EU's Approach to Ethnic Minorities' European University Institute (Working Paper No RSC 2000/4) 4.

EU's external policy of conditionality in combination with domestic factors and norm resonance. The conclusion also tries to envisage possible backlashes on the EU.

CASE AND ARGUMENT

So far, research on norms in international relations has mainly focused on 'robust' (ie strong and stable) norms in order to account for the diffusion of and compliance with international norms.[11] Work inspired by sociological institutionalism, with its stress on institutional isomorphism, deep internalisation and habitualisation, has specifically sought to make the case for a rule-following 'logic of appropriateness,'[12] which relies on stable norms to explain behaviour.[13] More recent constructivist approaches, claiming to 'bring agency back in' against the overly structuralist sociological institutionalist account, have done so mostly by studying agency in reaction to well established norms.[14] While others acknowledge contestation as a central feature of norms, they stress the contestation between norm types (rather than norm meanings), treating them as basic, atomistic and unproblematic units of analysis. Research has thus focused on the question of 'which norms matter?'[15] with a view to understanding the power of particular norm types, thereby leaving to one side the contested meaning of norms. Such a structural analytic perspective on norms neglects the role of practices within particular normative contexts. The variation in normative contexts and hence the increasing probability of norm contestation does, however, require particular attention in transnational orders such as the EU, all the more so under conditions of enlargement. Before we turn to

[11] J Legro, 'Which norms matter? Revisiting the 'failure' of internationalism' (1997) 51(1) *International Organization* 31–63. A Chayes and A Handler Chayes, 'On Compliance' (1993) 47(2) *International Organization* 175–205; A Chayes and A Handler Chayes, above n 3; D Jacobson, *Rights Across Borders: Immigration and the Decline of Citizenship* (Baltimore, Johns Hopkins University Press, 1996), R Jepperson et al 'Norms, Identity, and Culture in National Security' in P Katzenstein (ed), *The Culture of National Security. Norms and Identity in World Politics* (New York, Columbia University Press, 1996) 33–75; H H Koh, 'Why Do Nations Obey International Law?' (1997) 106 *The Yale Law Journal* 2599–659; K Sikkink, 'Human rights, principled issue networks, and sovereignty in Latin America' (1993) 47(3) *International Organization* 411–41.

[12] J March and J Olsen, *Rediscovering Institutions. The Organizational Basis of Politics* (New York, Free Press, 1989); J March and J Olsen, 'The Institutional Dynamics of International Political Orders' (1998) 52(4) *International Organization* 943–69.

[13] P DiMaggio and W Powell, 'Introduction' in W Powell and P DiMaggio (eds), *The New Institutionalism in Organizational Analysis* (Chicago, University of Chicago Press, 1991) 1–40; M Finnemore 'Norms, culture, and world politics: insights from sociology's institutionalism' (1996b) 50(2) *International Organization* 325–47.

[14] J Checkel, 'The Constructivist Turn in International Relations Theory' (1998) 50 *World Politics* 324–48.

[15] See J Legro above, n 11.

three case studies on contested meanings, the following section offers a theoretical discussion of neo-institutional and constructivist perspective on the construction, evolution and impact of norms.

Norm Resonance

This chapter conceptualises norm development in terms of historical institutionalism, which stresses that different historical and cultural developments lead to cross-national variation and unintended consequences of institution building, due to path dependencies and the resulting fact that '[t]he common imposition of a set of rules will lead to widely divergent outcomes in societies with different institutional arrangements.'[16] This insight becomes even more relevant once we acknowledge that norm development takes place not only in different national settings, but also on the regional and global level, thus creating multiple path-dependencies and a need for the translation or mediation of meaning when norms are transferred from one level to another. This brings the issue of norm resonance to the fore: new norms have to be modelled so as to 'resonate with pre-existing collective identities embedded in political institutions and cultures in order to constitute a legitimate political discourse.'[17] As a starting point, this is mostly presented as an argument about 'cultural match' and institutional 'goodness of fit,' on the one hand,[18] and the social embeddedness of formal institutions, on the other.[19]

Contrary to the rationalist point of view, under which a 'misfit' between domestic and international norms creates the adaptational pressure necessary to provoke domestic change,[20] historical institutionalists and social constructivists maintain that only when new norms can be related to

[16] D North, Institutions, *Institutional Change and Economic Performance* (Cambridge, Cambridge University Press, 1990) 101; P Pierson, 'The Path to European Integration: A Historical Institutionalist Analysis' (1996) 29(2) *Comparative Political Studies* 123–63; K Thelen and S Steinmo, 'Historical institutionalism in comparative politics' in S Steinmo, K Thelen and F Longstreth (eds), *Structuring politics: Historical institutionalism in comparative analysis* (Cambridge, Cambridge University Press, 1992) 1–32.

[17] M Marcussen et al, 'Constructing Europe? The evolution of French, British and German nation state identities' (1999) 6(4) *Journal of European Public Policy* 615; M Finnemore and K Sikkink, 'International Norm Dynamics and Political Change' (1998) 52(4) *International Organization* 908.

[18] S Bulmer and M Burch, 'The "Europeanisation" of Central Government: the UK and Germany in Historical Institutionalist Perspective' in M Aspinwall and G Schneider (eds), *The Rules of Integration. Institutionalist Approaches to the Study of Europe* (Manchester, Manchester University Press, 2001) 73–96.

[19] A Wiener, 'The Embedded *acquis communautaire*. Transmission Belt and Prism of New Governance' (1998) 4(3) *European Law Journal* 294–315.

[20] T Börzel and T Risse, 'When Europe Hits Home: Europeanization and Domestic Change' (2000) *European Integration online Papers* 4, 15.

established institutions, traditions and beliefs, does norm transfer become possible. In this view, resonance is a structural precondition to effective norm diffusion, which in turn delineates the extent to which a norm may be accommodated within the new context. However, since complex normative structures consist of sometimes competing or even contradictory norms and broad principles in need of interpretation, they cannot determine a unique outcome in a structuralist fashion, but merely provide 'resonance points' to which a new norm can be related.[21] Thus, 'norms create permissive conditions for action but do not determine action.'[22]

Although an institutional analysis looking for 'resonance points' within the constitutive normative framework into which a norm is to be introduced is a starting point for assessing the range of possible resonant norms or norm interpretations, resonance is not simply 'out there' as a structural property of the norms themselves and therefore as an independent measure of norm robustness. It also includes an agency-oriented, dynamic and interactive element, insofar as 'the meanings of any particular norm and the linkages between existing norms and emergent norms are often not obvious and must be actively constructed by proponents of new norms.'[23] Resonance therefore also entails an ability to create compelling and coherent arguments within a social context with regard to the norm and to relate the norm positively to institutions, traditions, and ideas that are prevalent in that context. In other words, one important question regarding norm transfer from the international to the national level is how international norms are introduced into the process of domestic norm construction.

To explain the emergence of new norms, as well as the transposition of international norms into domestic contexts, scholars have begun to study the actions of 'norm entrepreneurs,' ie agents actively promoting the norm. First, international organisations themselves can act as 'teachers of norms.'[24] To account for the role of international organisations in persuading national elites, some scholars are studying meetings between representatives of both sides. Once persuaded, the national representatives then become norm entrepreneurs in the domestic arena, assuming they are not themselves in a position to implement the norms directly. Second, following a 'bottom-up' process of societal pressure and mobilisation, norm entrepreneurs can act

[21] G Schwellnus 'Much ado about nothing? Minority Protection and the EU Charter of Fundamental Rights' *Institute of European Studies, Queen's University of Belfast* (ConWEB Paper 5/2001).
[22] M Finnemore, 'Constructing Norms of Humanitarian Intervention' in P Katzenstein (ed*), The Culture of National Security. Norms and Identity in World Politics*. (New York, Columbia University Press, 1996) 158.
[23] M Finnemore and K Sikkink, above n 17, 908.
[24] K Sikkink, above n 11.

as 'advocacy coalition networks' within the applicant states, mobilising public support against a reluctant government, whether out of principled commitment or for instrumental reasons.[25]

A third possible factor is the involvement of domestic or transnational experts acting as 'epistemic communities'[26] which promote EU rules internally as a model for domestic legislation. While work on epistemic communities has so far focused mainly on scientific expertise in highly technical policy areas, the concept has recently also been extended to lawyer communities.[27] Rather than mobilising against norm-breaching governments, political elites voluntarily include specialists in the domestic process of norm construction, since they can provide expertise and consensual interpretations sufficient to overcome the uncertainty that inheres in the absence of clear obligations and models. The influence of epistemic communities thus depends on favourable domestic conditions: a demand by political elites for expertise is a precondition for inclusion of experts in the process. Still, from the perspective of norm resonance, transnational communities of legal specialists are in a position, given their knowledge of both international and domestic norms, to perform an important function as catalysts or 'mediators of meaning'.[28]

NON-DISCRIMINATION AND MINORITY RIGHTS: EU RULES AND CONDITIONALITY

For purposes of this chapter, non-discrimination and special minority rights will be treated as two distinct norms used to achieve the protection of minorities. While the norms do not necessarily contradict each other and can be combined in a comprehensive approach to minority protection,[29] they can still be distinguished and follow different

[25] M Finnemore and K Sikkink, above n 17; M Keck and K Sikkink, *Activists beyond Borders: Advocacy Networks in International Politics* (Ithaca, Cornell University Press, 1998); A Klotz, *Norms in International Relations: The Struggle Against Apartheid* (Ithaca/London, Cornell University Press, 1995).

[26] E Adler and P Haas, 'Conclusion: epistemic communities, world order, and the creation of a reflective research program' (1992) 46(1) *International Organization* 367–90.

[27] F van Waarden and M Drahos, 'Courts and (epistemic) communities in the convergence of competition policies' (2002) 9(6) *Journal of European Public Policy* 913–34.

[28] A Kieser, 'Konstruktivistische Ansätze' in A Kieser (ed), *Organisationstheorien* 3rd edn (Stuttgart et al., Kohlhammer, 1999) 287–318; A Wiener, 'Zur Verfassungspolitik jenseits des Staates: Die Vermittlung von Bedeutung am Beispiel der Unionsbürgerschaft' (2001) 8(1) *Zeitschrift für Internationale Beziehungen* 73–104. See also O Elgstrøm, 'Consolidating "Unobjectionable" Norms: Negotiating Norm Spread in the EU' (Paper presented at the ECPR 4th Pan-European IR-conference, Canterbury, 8–10 September 2001); S Ratner, 'Does International Law Matter In Preventing Ethnic Conflict? (2000) 32 *Journal of International Law and Politics* 591–698.

[29] Open Society Institute, *Monitoring the EU Accession Process: Minority Rights — Minority Protection in the EU Accession Process* (Budapest, Open Society Institute, 2001a) <http://www.eumap.org/reports/content/10/001/minority_accession.pdf> (26 February 2004) 16.

rationales: First, non-discrimination is a general human rights principle (so that 'belonging to a national minority' is only one among many reasons for discrimination to be eliminated), whereas special minority rights are group-specific, ie targeted at particular persons or groups. A related issue is that non-discrimination as a general human right is applicable to all persons, while special minority rights can be restricted to citizens. Although the definition of minorities is in fact highly contested,[30] it is predominantly meant to protect long-term resident 'old' or 'national' minorities rather than the 'new' minorities created by migration and therefore restricted to citizens.[31]

Secondly, while non-discrimination aims at the removal of all obstacles to the enjoyment of equal rights and full integration of persons belonging to minorities into society, special minority protection requires permanent positive state action in support of the minority group, in order to preserve its identity and prevent assimilation.[32] Minority protection is therefore a positive right, whereas non-discrimination is predominantly a negative right, although it can be interpreted in a way that allows at least temporarily for positive measures to counter de facto inequalities.[33] Thirdly, non-discrimination is mostly viewed as an individual human right. By contrast, the question whether special minority rights should be conceptualised as individual or collective rights, ie as rights granted to persons belonging to minorities or rights granted to the groups as such in the form of self-government, autonomy or self-determination, remains highly contested. Thus, while interpretation of the non-discrimination principle may vary between a formal and a substantive reading, depending on whether 'affirmative action' is allowed or not, special minority rights can conceptually be subdivided into individual and collective minority protection concepts.[34]

[30] R Hofmann, 'Minderheitenschutz in Europa. Überblick über die völker- und staatsrechtliche Lage' (1992) 52 *Zeitschrift für ausländisches öffentiches Recht und Völkerrecht* 1–69.

[31] This applies specifically to the context of European minority norms. C Thiele, 'The Criterion of Citizenship for Minorities: The Example of Estonia' *European Center for Minority Issues* (Working Paper No 5 Flensburg, 1999). The UN, on the other hand, has come to include non-citizens in their minority-definition. A Eide, 'Citizenship and the Minority Rights of Non-Citizens' (Working paper submitted to the UN Commission on Human Rights, Sub-Commission on the Promotion and Protection of Human Rights, Working Group on Minorities, 5th session, 25–31 May 1999). UN Doc. E/CN.4/Sub.2/AC.5/1999/WP.3.

[32] J Niewerth, *Der kollektive und der positive Schutz von Minderheiten und ihre Durchsetzung im Völkerrecht* (Berlin, Duncker & Humblot, 1996).

[33] P Thornberry, *International Law and the Rights of Minorities* (Oxford, Clarendon, 1991) 126. Still, the aims of non-discrimination and minority protection remain different: positive measures under non-discrimination are by definition only to be employed temporarily and are put into place to remove the underlying distinction, while special minority rights are essentially permanent and aim at the preservation of the distinctive character of the minority group.

[34] For an overview on collective minority protection cf G Brunner, 'Minderheitenrechtliche Regelungskonzepte in Osteuropa' in G Brunner and B Meissner (eds), *Das Recht der nationalen Minderheiten in Osteuropa* (Berlin, Spitz, 1999) 39–73; J Niewerth, above n 33. For a liberal-individualist critique cf B Barry, *Culture and Equality. An Egalitarian Critique of*

Table 1: Concepts of Non-Discrimination and Special Minority Rights

Non-Discrimination		Special Minority Rights	
Formal Non-Discrimination	Substantive Non-Discrimination	Individual Minority Rights	Collective Minority Rights
- general	- predominantly general, group-specific measures allowed to achieve de facto equality	- group-specific	- group-specific
- negative	- predominantly negative, positive measures temporarily allowed to reverse past discrimination and achieve de facto equality	- permanent positive measures required	- permanent positive measures required
- individual	- individual	- individual	- collective

EU Rules and Conditionality in the Field of Non-Discrimination

Non-discrimination has been a fundamental principle within the European Community from the beginning, in the form of gender equality and the abolition of discrimination on the basis of nationality between member states.[35] Furthermore, although the original treaties did not contain human rights provisions, the European Court of Justice exercised a competence for human rights issues within its case law,[36] at least within the scope of community law, which was later codified by the Maastricht Treaty's introduction of Article 6(2) of the Treaty of the European Union (TEU).[37] Since the Amsterdam Treaty, the non-discrimination framework has been expanded to include ethnic and racial discrimination: Article 13 ECT enables the

Multiculturalism (Cambridge, Polity Press, 2001); J Donnelly, 'The Universal Declaration Model of Human Rights: A Liberal Defense' in G Lyons and J Mayall (eds), *International Human Rights in the 21st Century: Protecting the Rights of Groups* (Lanham, Rowman & Littlefield, 2003) 20–45.

[35] The latter was codified in art 6 (now art 12) ECT, the former was established first in art 119 (now art 141) ECT regarding 'equal pay' and later specified and extended in the Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions [1976] OJ L039/40.

[36] For the establishment of Human Rights as general principles of Community law see Case 29/69 *Stauder* [1969] ECR 419; Case 11/70 *Internationale Handelsgesellschaft* [1970] ECR 1125 and Case 4/73 *Nold* [1974] ECR 491. Subsequently, the ECJ regularly referred to the ECHR as the basic European human rights document (see eg Case 36/75 *Rutili* [1975] ECR 1219). L Betten and N Grief, *EU Law and Human Rights* (London/New York, Longman, 1998) 56–59.

[37] Art 6(2) TEU: 'The Union shall respect fundamental rights, as guaranteed by the European Convention on Human Rights and Fundamental Freedoms (…) and as they result from the constitutional traditions common to the Member States, as general principles of Community law'.

Community to 'take appropriate action to combat discrimination based on sex, racial or ethnic origin, religion or belief, disability, age or sexual orientation',[38] again within the scope of the Treaty. This furnished a basis for the adoption of a framework directive on equal treatment in employment and occupation,[39] and, more significantly, a directive on the prohibition of discrimination on the basis of racial or ethnic origin (the so-called 'Race Equality Directive').[40] Building on ECJ rulings on 'affirmative action' in the field of gender discrimination,[41] the directives contain a provision allowing for 'measures intended to prevent or compensate for disadvantages suffered by a group of persons of a particular racial or ethnic origin'.[42] This is also reflected in ECJ rulings acknowledging that 'the protection of (…) a minority may constitute a legitimate aim'[43] of national policy and therefore does not in itself run afoul of the non-discrimination principle. As the most recent EU development, the Charter of Fundamental Rights includes 'belonging to a national minority' in the non-discrimination list.[44]

It follows that non-discrimination may be regarded as a reasonably clear and well-established norm at the EU level.[45] It is also largely congruent with international non-discrimination norms, as laid down generally in the Universal Declaration of Human Rights and the UN Charter, and more specifically in Article 26 of the United Nations' International Covenant on Civil and Political Rights (ICCPR), which prohibits discrimination, among others, on the ground of race and national origin,[46] the UN Convention on

[38]Art 13 ECT. Cf G Toggenburg, 'A Rough Orientation Through a Delicate Relationship: The European Union's Endeavours for (its) Minorities' *European Integration online Papers* (Vol 4 No 12, 2000) 20 ff.

[39]Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation [2000] OJ L303/16–22.

[40]Council Directive 2000/43/EC of 29 June 2000 implementing the principle of equal treatment between persons irrespective of racial or ethnic origin [2000] OJ L180/22–26.

[41]ECJ Case C-450/93 *Kalanke* [1995] ECR I-3051 and Case C-409/95 *Marschall* [1997] ECR I-6363. For a thorough discussion of both cases and the shift they imply see L Charpentier, 'The European Court of Justice and the Rhetoric of Affirmative Action' (1998) 4(2) European Law Journal 167–195.

[42]Council Directive 2000/43/EC of 29 June 2000 implementing the principle of equal treatment between persons irrespective of racial or ethnic origin [2000] OJ L180/22, s 17.

[43]Case C-274/96 *Bickel/Franz* [1998] ECR I-7637, s 12. Other minority related cases include Case C-379/87 *Groener* [1989] ECR 3967 and Case C-281/98 *Angonese* [2000] ECR I-4139. Cf also B De Witte, 'Free Movement of Persons and Language Legislations of the Member States of the EU. Some Reflections after the Recent Judgement in Bickel and Franz' (1999) 18 *Academia* 1–4.

[44]Art 21: 'Any discrimination based on any ground such as sex, race, colour, ethnic or social origin, genetic features, language, religion or belief, political or any other opinion, membership of a national minority, property, birth, disability, age or sexual orientation shall be prohibited.' Charter of Fundamental Rights of the European Union [2000] OJ C364/13 <http://www.europarl.eu.int/charter/pdf/text_en.pdf> (26 February 2004).

[45]Open Society Institute (2001a), above n 29, 22.

[46]ICCPR art 26: 'All persons are equal before the law and are entitled without any discrimination to the equal protection of the law. In this respect, the law shall prohibit any discrimination and guarantee to all persons equal and effective protection against discrimination on any

the Elimination of All Forms of Racial Discrimination (CERD),[47] and Article 14 of the Council of Europe's European Convention on Human Rights (ECHR), which includes national minorities in a general non-discrimination clause.[48] Non-discrimination is also part of EU conditionality, although there is variation with regard to its strength across different Central and Eastern European Countries (CEE countries). On the one hand, since all applicant countries are subject to a general requirement of complete adoption of the *acquis*, they all have a general obligation to develop non-discrimination legislation and specifically to implement the Race Equality Directive. On the other hand, Commission reports make explicit and constant reference to discrimination against Roma, particularly in those accession countries, where their situation is especially problematic. Hence, we can distinguish between general but rather weak and implicit conditionality for all applicants, on the one hand, and strong and explicit conditionality in 'problematic' cases, on the other.

EU Rules and Conditionality in the Field of Minority Protection

In sharp contrast to the principle of non-discrimination, the EU has not developed a minority rights standard within the internal *acquis communautaire*, nor do the member states subscribe to a single European standard.[49] In the accession *acquis,* the minority criterion also remained ill-defined, thus failing to develop a clear and common standard for all the applicant states. This is partly due to the fact that, despite considerable attempts by all major international organisations — the UN, the Organization for Security and Co-operation in Europe (OSCE), the Council of Europe — to develop a minority rights standard after the end of the Cold War, protection of minority rights remains a contested norm that is not consensually shared internationally and is susceptible to a wide range of interpretations.

ground such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status'. UN GA Res 2200A (XXI).

[47] UN GA Res 2106 (XX) of 21 December 1965.

[48] ECHR art 14: 'The enjoyment of the rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status'. Council of Europe Convention for the Protection of Human Rights and Fundamental Freedoms, Rome, 4.XI.1950 <http://conventions.coe.int/treaty/en/Treaties/Html/005.htm> (26 February 2004).

[49] Cf G Amato and J Batt, 'Minority Rights and EU Enlargement to the East. Report of the First Meeting of the Reflection Group on the Long-Term Implications of EU Enlargement: The Nature of the New Border' *European University Institute* (Florence, RSC Policy Paper 98/5 1998); B De Witte 2000, above note 10; G Pentassuglia, 'The EU and the protection of Minorities: The Case of Eastern Europe' (2001) 12 *European Journal of International Law* 3–38; G Schwellnus, above n 21; G Toggenburg, above n 38.

It is true that the EU's internal non-discrimination rules seem conceptually much closer to the rather 'thin' approach to minority protection taken by the UN,[50] which does not require active promotion of minorities,[51] which grants minority protection also to non-citizens,[52] and which strictly rejects collective rights and any connection to self-determination. Yet, the EU has mainly referred to European standards in its external minority rights policy. While the EU and member states made early reference to the politically binding norms developed in the Conference on Security and Cooperation in Europe (CSCE) and the OSCE context,[53] and in specific cases followed the recommendations of the OSCE High Commissioner on National Minorities, which often invoke international standards but follow a case-by-case approach aimed at crisis prevention,[54] the standard to which the applicants states are held can be derived from the Agenda 2000:

> A number of texts governing the protection of national minorities have been adopted by the Council of Europe, in particular the Framework Convention for the Protection of National Minorities and recommendation 1201 adopted by the Parliamentary Assembly of the Council of Europe in 1993. The latter,

[50] See eg ICCPR art 27: 'In those States in which ethnic, religious or linguistic minorities exist, persons belonging to such minorities shall not be denied the right, in community with the other members of the group, to enjoy their own culture, to profess and practice their own religion, or to use their own language.' (cited in P Ghandhi, above n 51, 70) and the Declaration of Rights of Persons Belonging to National or Ethnic, Religious and Linguistic Minorities in 1992 (UN Doc A/RES/47/135).

[51] D Blumenwitz and M Pallek, 'Draft of a minority protection clause in the Charter on Fundamental Rights of the European Union. Contribution by the International Institute for Right of Nationality and Regionality' (2000) CHARTE 4301/00 CONTRIB 173, 17/05/2000 <http://db.consilium.eu.int/df/default.asp?lang=en> (26 February 2004) 49.

[52] Thiele, above n 31, 4. Cf also A Eide, 'Protection of Minorities. Possible ways and means of facilitating the peaceful and constructive solution of problems involving minorities' *UN Commission on Human Rights, Sub-Commission on the Prevention of Discrimination and Protection of Minorities* (report submitted by the Special Rapporteur 45th session, 10 August 1993) UN Doc. E/CN.4/Sub.2/1993/34; A Eide, above n 31; A Eide, 'Commentary to the Declaration on the Rights of Persons Belonging to National or Ethnic, Religious and Linguistic Minorities' United Nation Commission on Human Rights, Sub-Commission on the Promotion and Protection of Human Rights Working Group on Minorities (working paper 6th session, 22–26 May 2000) UN Doc. E/CN.4/Sub.2/AC.5/2000/WP.1; 'CCPR General Comment 23: The rights of minorities (Article 27)' UN Commission on Human Rights: (8 April 1994) s 5.2.

[53] Especially the Document of the Copenhagen Meeting of the Conference on the Human Dimension of the CSCE, 5 June — 29 July 1990 <http://www.osce.org/docs/english/1990–1999/ hd/cope90e.htm> (26 February 2004).

[54] M Brusis, 'The European Union and Interethnic Power-sharing Arrangements in Accession Countries' (2003) *Journal of Ethnopolitics and Minority Issues in Europe* 1/2003 <http://www.ecmi.de/jemie/download/Focus1-2003_Brusis.pdf> (26 February 2004); J Hughes and G Sasse, 'Monitoring the Monitors. EU Enlargement Conditionality and Minority Protection in the CEECs'(2003) *Journal of Ethnopolitics and Minority Issues in Europe* 1/2003 <http://www.ecmi.de/jemie/download/Focus1-2003_Hughes_Sasse.pdf> (26 February 2004); W Kymlicka, 'Reply and Conclusion' in W Kymlicka and M Opalski (eds), *Can Liberal Pluralism be Exported? Western Political Theory and Ethnic Relations in Eastern Europe* (Oxford/New York, Oxford University Press, 2001) 347–413.

> though not binding, recommends that collective rights be recognised, while the Framework Convention safeguards the individual rights of persons belonging to minority groups.[55]

While Recommendation 1201 was rejected as an additional protocol to the ECHR, precisely because it included collective minority provisions in the form of territorial autonomy, the individualist approach taken by the Framework Convention seems to codify the highest achievable standard beyond non-discrimination shared by at least a majority of European countries.[56] In any case, the EU's external promotion of collective minority rights declined during the accession process.[57] Not only was it increasingly clear that collective minority rights had no chance of becoming the European standard in the near future, but the focus also shifted together with security concerns underlying the promotion of minority protection in the CEE countries from minority protection as a remedy to the threat of inter – or intra-state ethnic conflict to the situation of the Roma, and therefore to issues of non-discrimination in order to prevent mass migration. Subsequently, the EU increasingly linked minority protection and non-discrimination in their justifications for the minority criterion.[58] In sum, minority protection is neither an EU rule nor a strong rule within the accession *acquis*. It lacks a common standard, with the result that conditionality varies greatly across accession states. Some countries with problematic minority situations are under continuous scrutiny and face explicit and determinate, though not necessarily legitimate, EU demands; others have to comply with the minority criterion in general, but do not seem to be subject to any particular minority protection disciplines.

COMPLIANCE WITH EU CONDITIONALITY IN APPLICANT COUNTRIES: ROMANIA, HUNGARY, AND POLAND

The following section surveys the implementation of non-discrimination and special minority rights legislation in three applicant countries, with a view to determining whether and to what extent the EU's policy of

[55] European Commission Agenda 2000: For a stronger and wider Union. COM(97) 2000 Vol 1, 44.
[56] D Blumenwitz and T Pallek, above n 51, 45.
[57] In May 2001 the Commission replied to a written question that 'with regard to [the minority] criterion, the Commission devotes particular attention to the respect for, and the implementation of, the various principles laid down in the Council of Europe Framework Convention for the Protection of National Minorities'. Answer given by Mrs Reading on behalf of the Commission (15 May 2001) in reply to Written Question E-0620/01 by Nelly Maes, MEP (Verts/ALE), to the Commission (1 March 2001).
[58] J Hughes and G Sasse, above n 54.

conditionality has led to formal legislation in the candidate countries in line with either the *acquis* or with particularised rules demanded by EU accession criteria.[59] The case selection reflects variation in both EU rules and EU conditionality or rule promotion. As for the selection of EU norms, as developed in the previous part, non-discrimination is considered a strong and clear EU rule, while minority rights are neither established nor uncontested at the EU level. The country cases are then selected according to variation in the strength and determinacy of EU conditionality: Romania has been under explicit and persistent pressure to implement both special minority rights and measures to counter Roma discrimination. Hungary is a mixed case, in which only the Roma issue was addressed, while the minority protection standard was considered sufficient and even exemplary. Poland is a case where conditionality has been low in both areas.

Table 2: EU rules and conditionality in Romania, Hungary and Poland

		EU conditionality or rule promotion		
		Weak	Strong	
EU rules	Weak	Minority Rights: - Poland - Hungary	Minority Rights:	- Romania
	Strong	Non-discrimination: - Poland	Non-discrimination:	- Romania - Hungary

Case 1: Romania

As a state with significant internal but negligible external minorities, Romania traditionally figured among the opponents of minority protection.[60] Furthermore, the relation between the state and its minorities could also be characterised as a conceptual clash between a 'unitary and indivisible nation state,' ethnically defined,[61] that rejected collective minority rights, on the one hand,[62] and strong and ever more radicalised claims to collective protection

[59] By focusing exclusively on legislative measures, it follows a purely formal conception of rule adoption, being fully aware that this is not to be equated with de facto implementation or social acceptance, for which social in addition to legal internalisation would be needed. See H H Koh, above n 11, 12. It also does not mean that the situation of minorities is fundamentally better in states with adopted minority legislation than in those without.

[60] S Bartsch, *Minderheitenschutz in der internationalen Politik. Völkerbund und KSZE/OSZE in neuer Perspektive* (Opladen, Westdeutscher Verlag, 1995); R Hofmann, above n 30. According to the 1992 census minorities constitute officially 10.7% of the Romanian population.

[61] Art 1/1 and 4/1 of the Romanian Constitution of 21 November 1991.

[62] Accordingly, the 1991 constitution does not include collective minority provisions, despite initial promises of the new post-1989 government to 'guarantee individual and collective rights

and autonomy by the Hungarian minority, on the other, leading to a 'permanent tension between the expectations of the historical minorities regarding protection based on group rights, and the fears of the Romanian governments that far reaching minority rights and autonomy might be a prelude to secession.'[63] Given these conflictive domestic conditions, the positive developments achieved since the mid-90s are best explained by the strong and persistent promotion of minority protection by international organisations. Furthermore, the EU also explicitly linked improvements in minority protection to the prospect of Romanian membership. However, the most profound improvement only occurred after the 1996 elections, when the former government, which depended heavily on nationalist forces, was replaced by a democratic and emphatically pro-Western coalition including a Hungarian party.

There were, moreover, limitations to the effectiveness of EU conditionality, which were related to the contested character of the minority rights norm and its resonance within the domestic context. This is most obvious in the failure of international pressure and conditionality to overcome strong domestic resistance and produce a collective minority standard. Although Romania accepted Recommendation 1201, first in relation to its accession to the Council of Europe,[64] and then in a bilateral treaty with Hungary (which was signed under international pressure and EU conditionality), it rejected the notion of collective rights and autonomy that was included in the document and insisted that an additional footnote be added to the treaty. This re-interpretation was criticised by the Western organisations and by Hungary, as well as by the Hungarian minorities themselves. It could be justified, however, on the basis of the existing European standard, as represented by the Framework Convention, and it was finally accepted.

In the following years, EU attention shifted from the issue of special minority rights to the issue of discrimination, especially with regard to Romania's Roma population. The European Commission report of 2000 concluded that 'the treatment of minorities in Romania is mixed. The lack of progress with regard to tackling discrimination against the Roma is a subject which has been raised in previous regular reports but which has still

and freedoms for ethnic minorities' see M Shafir, 'The Political Party as National Holding Company: The Hungarian Democratic Federation of Romania' in J Stein (ed), *The Politics of National Minority Participation in Post-Communist Europe — State-Building, Democracy, and Ethnic Mobilization* (Armonk and New York, M.E. Sharpe, 2000) 102. Cf G Tontsch, 'Der Minderheitenschutz in Rumänien' in G Brunner and G Tontsch (eds), *Der Minderheitenschutz in Ungarn und Rumänien*. (Bonn, Kulturstiftung der deutschen Vertriebenen, 1995) 148. It entails, however, positive individual clauses.

[63] G Tontsch, *ibid*, 235 [translation from German by Guido Schwellnus].
[64] M Ram, 'Minority Relations in Multiethnic Societies: Assessing the European Union Factor in Romania' (2001) 1(2) *Romanian Journal of Society and Politics* 63–90, 72.

not been adequately addressed. On the other hand, a series of progressive initiatives has greatly improved the treatment of other minorities.'[65] Thus, the EU spelled out non-discrimination as a missing element in the Romanian minority protection system. The Romanian government responded to this assessment by adopting an Ordinance on the Prevention and Punishment of All Forms of Discrimination in November 2000, which 'gives Romania the most comprehensive anti-discrimination framework among EU candidate countries',[66] and which incorporates many aspects of the EU directive against racial discrimination. The 2001 Commission report praised it as a major anti-discrimination development.[67]

In sum, both minority protection and non-discrimination legislation in Romania seem to have been in large part triggered by external conditionality and rule promotion, especially by the EU. However, externally driven rule adoption was limited to minority protection concepts that resonated with Romanian institutions, ensuring that 'the treatment of individuals rather than groups as the subject of minority rights legislation has been fairly consistent over the past decade'[68]. This individualist preoccupation could not even be overcome by a combination of minority mobilisation, kin-state support, and EU conditionality.

Case 2: Hungary

With regard to minority protection, Hungary can hardly be viewed as an instance of EU conditionality or Western norm transfer in any meaningful sense. Not only was the legal system, guaranteed by the constitution and specified in the Minority Act of 1993, well developed by the time the minority criterion in the EU accession *acquis* was formulated, but Hungary has long been a promoter of minority rights; it was in fact among the main forces seeking to put minority protection on the international agenda after 1989. On the other hand, Hungary failed in its attempts to 'upload' the internally developed collective minority protection standard onto the international level, given the predominantly liberal-individualist character of the current

[65] 2000 Regular Report of the Commission on Romania's Progress towards Accession (Brussels, 8 November 2000,) <http://europa.eu.int/comm/enlargement/report_11_00/ pdf/en/ro_en.pdf> (26 February 2004) 24 ff.
[66] Open Society Institute, Monitoring the EU Accession Process: Minority Rights — Minority Protection in Romania. (Budapest, Open Society Institute, 2001d) <http://www.eumap.org/reports/content/10/642/minority_romania.pdf> (26 February 2004) 393.
[67] Commission of the European Communities: 2001 Regular Report on Romania's Progress towards Accession. SEC(2001) 1753 (Brussels, 13 November 2001) <http://europa.eu.int/comm/enlargement/report2001/ro_en.pdf> (26 February 2004) 22.
[68] I Horváth and A Scacco, 'From the Unitary to the Pluralistic: Fine-Tuning Minority Policy in Romania' in A-M Bíró and P Kovács (eds), *Diversity in Action. Local Public Management of Multi-Ethnic Communities in Central and Eastern Europe* (Budapest, IGI Books and Open Society Institute, 2001) 253.

European and global human rights norms, as well as the strong opposition to collective minority rights among some Western European countries.

Two main reasons account for the unique Hungarian approach to minorities. There is, first, a specific minority situation. Not only does Hungary have large external minorities (ie fellow-Hungarians constituting minorities in neighbouring countries) and a rather low percentage of internal minorities, but the external minorities are predominantly concentrated territorially, while the internal minorities are dispersed, well integrated and to a large extent assimilated.[69] All of this gave Hungary a strong incentive to promote collective rights. Second, the cornerstones of minority protection go back to an intellectual tradition based on the concept of 'personal autonomy,' which was first proposed by Karl Renner as a model for the Austro-Hungarian empire and subsequently developed by Hungarian scholars.[70] Thus, it is clearly domestic conditions and legacies, not European norms, that were the driving forces behind the development of the Hungarian minority protection system. Since the level of minority protection in Hungary was perceived as exceeding European standards, this conceptual difference was praised, rather than criticised, in the EU assessments.

The purely domestic factors accounting for the Hungarian minority protection system gain importance for a study of EU influence only when combined with an assessment of the Hungarian record on non-discrimination. The Hungarian constitution includes a general non-discrimination provision, and several laws feature anti-discrimination clauses. On the other hand, Hungary does not have general anti-discrimination legislation. NGOs complained that, apart from being scattered, 'Hungary's anti-discrimination legal framework is largely inoperative.'[71] The European Commission has repeatedly addressed the issue of discrimination, specifically with regard to the Roma population, beginning with the initial accession opinion and throughout the annual reports.[72] Furthermore, combating Roma discrimination was prominently included in the accession partnership.[73] Therefore, the non-discrimination principle is supported not only by reasonably clear European standards, but also by persistent EU conditionality. Still, these demands have not been transposed into anti-discrimination legislation.

[69] A Krizsán, 'The Hungarian Minority Protection System: a flexible approach to the adjudication of ethnic claims' (2000) 26(2) *Journal of Ethnic and Migration Studies* 247.
[70] *Ibid*, 250 ff.
[71] Open Society Institute, Monitoring the EU Accession Process: Minority Rights — Minority Protection in Hungary (Budapest, Open Society Institute, 2001b) <http://www.eumap.org/reports/content/10/348/minority_hungary.pdf> (26 February 2004) 224.
[72] Commission Opinion on Hungary's Application for Membership of the European Union, DOC/97/13 (Brussels, 15 July 1997) <http://europa.eu.int/comm/enlargement/dwn/opinions/hungary/hu-op-en.pdf> (26 February 2004) 20.
[73] DG Enlargement: Hungary: 1999 Accession Partnership (Brussels, 1999) <http://europa.eu.int/comm/enlargement/dwn/ap_02_00/en/ap_hu_99.pdf> (26 February 2004) 4.

Although the Ombudsman for Minorities produced a draft, the Minister of Justice in 2000 explicitly rejected the idea of introducing legislation in this field. Rather, external pressures to implement anti-discrimination measures seem to have been re-interpreted and 'diverted' into measures within the positively assessed collective minority protection system. This was reinforced by the Commission's judgment that, despite obvious legal shortcomings, Hungary had fulfilled its short-term priorities on the issue.[74] Only in 2001 was a committee established to review existing legislation, and a non-discrimination law is currently under preparation. Although this means that Hungary will finally adopt EU rules, the time lag compared to Romania is considerable.

Case 3: Poland

In Poland, EU conditionality with regard to minority rights and non-discrimination has been very low, due to the fact that throughout the accession process the Commission considered the political criteria fulfilled.[75] Nonetheless, NGOs have described Polish non-discrimination legislation as being 'minimal' and falling 'far below the requirements of the EU Race Equality Directive.'[76] The Polish Constitution contains a general non-discrimination clause, but simple legislation, especially on racial discrimination, is virtually absent. This has not, however, raised much EU concern. For example, the 2000 Commission report confines itself to the lapidary statement (found in most of the other applicants assessments as well) that 'legislation transposing the EC directive based on Article 13 relative to discrimination on the grounds of race or ethnic origin has to be introduced and implemented.'[77] The 2001 report notes, in a similarly unspectacular fashion, that 'the transposition of this principle, including the anti-discrimination *acquis*, has been limited.'[78] Significantly, despite the legal shortcomings, the issue of non-discrimination was not specifically connected to the situation of the Roma, which, contrary to the other cases, 'has not been a focal point

[74] Open Society Institute (2001b), above n 71, 218.
[75] Cf: Commission Opinion on Poland's Application for Membership of the European Union, DOC/97/16 (Brussels, 15 July 1997) <http://europa.eu.int/comm/enlargement/dwn/opinions/poland/po-op-en.pdf> (26 February 2004).
[76] Open Society Institute, Monitoring the EU Accession Process: Minority Rights — Minority Protection in Poland (Budapest, Open Society Institute, 2001c) <http://www.eumap.org/reports/content/10/616/minority_poland.pdf> (26 February 2004) 350 and 346.
[77] 2000 Regular Report of the Commission on Poland's Progress towards Accession (Brussels, 8 November 2000) <http://europa.eu.int/comm/enlargement/report_11_00/pdf/en/pl_en.pdf> (26 February 2004) 57.
[78] Commission of the European Communities: 2001 Regular Report on Poland's Progress towards Accession. SEC(2001) 1752 (Brussels, 13 November 2001) <http://europa.eu.int/comm/enlargement/report2001/pl_en.pdf> (26 February 2004) 22.

in Poland's EU accession negotiations.'[79] It can therefore ultimately be concluded that the low adaptational pressure on Poland in the area of non-discrimination has contributed to the neglect of the issue in Polish domestic legislation, the robustness and clarity of the norm in the EU context notwithstanding.

A similar outcome might therefore be expected in the area of minority rights. At first sight, this conclusion is supported by the fact that after external pressures — especially coming from Germany — were responded to through bilateral treaties,[80] and after some legislative measures concerning preferential representation and education for minorities were introduced, the development of comprehensive minority legislation was (and still is) slow and contested.[81] However, even the Polish reluctance to ratify the Framework Convention, which the EU considers to be the central European minority rights instrument, was barely criticised in the EU assessments.[82] Still, the Polish case remains a puzzle when it comes to explaining the emerging minority protection model, which is normally described as following the principle of 'positive support and protection of individual rights of persons belonging to minorities (positive individual approach) (…) based on OSCE and Council of Europe standards.'[83]

This outcome, while obviously not a result of external pressure, also cannot be accounted for by a purely domestic explanation, for no clear national preference for a specific minority protection model can be deduced either from the minority situation or from national institutions or legacies.[84] Furthermore, far from having an established view on the issue, Polish political elites faced a high degree of uncertainty as to the form

[79] Open Society Institute (2001c), above n 76, 345.

[80] S Łodziński, 'Minority Rights in Poland' (Warsaw, Helsinki Committee in Poland, 1999); P Mohlek, 'Der Minderheitenschutz in der Republik Polen' in P Mohlek and M Hošková (eds), *Der Minderheitenschutz in der Republik Polen, in der Tschechischen und in der Slowakischen Republik* (Bonn, Kulturstiftung der deutschen Vertriebenen, 1994) 9–82.

[81] P Vermeersch 'EU Enlargement and Minority Rights Policies in Central Europe: Explaining Policy Shifts in the Czech Republic, Hungary and Poland' (2003) *Journal of Ethnopolitics and Minority Issues in Europe* 1/2003 <http://www.ecmi.de/jemie/download/Focus1-2003_Vermeersch.pdf> (26 February 2004) 10–11.

[82] Although Poland signed the Framework Convention on the first day it was opened for signature in 1995, it was not before 1999 that the ratification document entered parliament for the first reading. The Convention was ratified in December 2000 and came into force in April 2001, which made Poland one of the last applicant countries to do so (only Latvia has still not ratified it and was severely criticised by the EU for this failure). As an example for the almost non-existent criticism in the Polish case, the 2000 report simply stated that 'Poland has ratified the major Human Rights conventions with the exception of the Council of Europe's Framework Convention on the protection of National Minorities (…) and has an established track record of providing appropriate international and constitutional legal safeguards for human rights and protection of minorities'. 2000 Regular Report of the Commission on Poland's Progress towards Accession, above n 77, 57.

[83] S Łodziński, above n 80, 1.

[84] With a comparatively low amount of internal minorities (3–5%) and external minorities that do not necessarily benefit from international minority protection, because they are, eg in

of protection to be implemented when the minority problem was 're-discovered' in 1989, since they where rather taken by surprise by the mobilisation of minorities that were believed to be marginal or even non-existent.[85] On the other hand, the minorities themselves — in contrast to their Hungarian counterparts — had no clear idea as to the minority protection concept they preferred.[86] Absent sufficiently clearly defined internal or external determining factors, a closer look at the process of domestic norm construction and an inclusion of discursive (as opposed to formal institutional) factors of rule adoption is therefore required, if we are to explain the congruence between the emerging Polish minority standard and European norms. The following section elaborates in greater detail on the exceptional Polish case.

DOMESTIC NORM CONSTRUCTION AND EUROPEAN STANDARDS: CONTESTED MINORITY CONCEPTS IN POLAND

The first major advance in developing a Polish minority protection norm was the inclusion of a minority clause in a new constitution. This was done to ensure the protection of national minorities, whose status was still defined by a rigid non-discrimination clause which was found in the old communist constitution[87] and which, taken at face value, prohibited any form of minority protection by means of positive measures.[88] The drafts proposed in 1991 by constitutional committees of both chambers of the Polish parliament, the Sejm and the Senate, contained special minority clauses on the basis of collective formulations.[89] It therefore seems that the initial position in the debate over the minority clause to be included in a new Polish constitution was at least to some extent based on a collective understanding of minority rights. Moreover, the minority provisions contained in the constitutional proposals advanced by the major political parties in 1994 reflected a clear dichotomy between individualist

Germany, not recognised as minorities, no clear preference for or against collective minority rights can be deduced (Bartsch, above n 60), and historical legacies also vary widely.

[85] S Łodziński, above n 80, 3.

[86] A Gawrich, *Ethnische Minderheiten im Transformations- und Konsolidierungsprozess Polens — Verbände und politische Institutionen* (Unpublished dissertation, Bochum 2001) 255–256.

[87] Polish Constitution of 1952, Article 81(1) 'Citizens of the Republic of Poland, irrespective of nationality, race, or religion, shall enjoy equal rights in all fields of public, political, economic, social, and cultural life. Infringement of this principle by any direct or indirect privileges or restrictions of rights by reference to nationality, race, or religion shall be punishable.' <http://www.uni-wuerzburg.de/law/p101000_.html> (26 February 2004).

[88] P Mohlek, above n 80, 24.

[89] R Hofmann, above n 30, 50 ff; M Kallas 'Parlamentarische Arbeiten am Status der nationalen und ethnischen Minderheiten in Polen' (1995) 41(3) *Osteuropa Recht* 179; P Mohlek, above n 80, 26 and 62.

approaches promoted by liberal parties, which focused mainly on non-discrimination in a manner clearly reminiscent of Article 14 ECHR,[90] and positive minority provisions included in the drafts handed in by the post-communists and different groups of the Solidarity right based on a collective approach, following mostly the Senate draft.[91]

A third option resembling the 'positive individualist' approach taken by the Council of Europe's Framework Convention was developed within the Sejm committee on national and ethnic minorities. The committee initially based its work on the Senate draft. However, after consultation with legal advisors, it replaced the collective formulation with an individualised one.[92] This version was also adopted by a group of legal specialists set up to develop a unified document building on the different constitutional drafts,[93] and was subsequently adopted by the Constitutional Committee of the National Assembly in March 1995. However, discussion of the article was initially conducted along the old front line, with representatives of the Solidarity trade union (NSZZ-Solidarność) favouring a collective formulation[94] against strong opposition by the liberal Freedom Union (UW).[95] Again, the 'positive individualist' consensus was reached only after

[90] These were the proposals handed in by the liberal Democratic Union (UD) and on the part of President Walesa, which featured as the fundamental rights section a Charter of Rights and Freedoms elaborated by the Helsinki Committee, a Warsaw based human rights NGO. The drafts are repoduced in R Chruściak (ed), *Projekty Konstytucji 1993–1997 [Constitutional Projects 1993–1997]. II części* [2 volumes] (Warszawa, Wydawnictwo Sejmowe, 1997), I/75 and 267; M Kallas, above n 89, 182; P Mohlek, above n 80, 63.

[91] Cf for the different drafts R Chruściak, above n 90; M Kallas, above n 89; P Mohlek, above n 80.

[92] M Kallas, above n 89, 180.

[93] *Projekt jednolity Konstytucji Rzeczpospolitej Polskiej z dnia 20 I 1995 r. (w ujęciu wariantowym) [Unified project of a Constitution of the Republic of Poland*, 20 January 1995 (with alternative provisions)]. Cited in R Chruściak, above n 90, II/5–79, 12. Cf also J Tkaczynski and U Vogel 'Sieben Jahre nach der Wende: Die polnische Verfassung zwischen Oktroi und Obstruktion' (1997) 43 2/3 *Osteuropa Recht* 170. The unified document included only the individualist formulation, despite the different approaches taken in the party proposals and the possibility of providing optional variations for each paragraph.

[94] Piotr Andrzejewski (NSZZ-S) reiterated the draft article proposed by his party, which 'stands on the basis of the protection of minority rights also as group rights'. Komisja Konstytucyjna Zgromadzenia Narodowego, II kadencja, nr 14 (7 March 1995) [Constitutional Committee of the National Assembly, 2nd term, session no 14 (7 March 1995)], 62 of 109 [translation from Polish — GS]. Further cited as Constitutional Committee. All minutes of parliamentary debates and committee sessions are taken from the Polish parliament's database at <http://www. sejm.gov.pl> (4 March 2004). In addition, another member of the NSZZ-Solidarność proposed the original version elaborated by the Senate: Alicia Grześkowiak in Constitutional Committee II/14 (7 March 1995) 68.

[95] '[W]e cannot include into the Constitution rights in collective form, because we would entangle ourselves in problems that are extremely difficult to resolve. We know from our history that the granting of group rights and their inclusion in state laws led to nationality conflicts instead of resolving problems. (…) I am against all formulations (…) that propose the protection of group rights in the Constitution of the Republic of Poland'. Hanna Suchocka (UW) in Constitutional Committee II/14 (7 March 1995), above n 94, 69 ff [translation from Polish by Guido Schwellnus].

the intervention of legal advisors[96] and the invocation of international and European standards as examples of individual formulations of minority rights.[97]

An individually formulated minority clause, with some minor changes, was included in the final version of the constitution adopted on 2 April 1997.[98] It is widely recognised that the 'protection of minority rights prescribed by this article goes beyond general principles of equality and non-discrimination of citizens as embodied in the old (communist) Constitution of 1952',[99] and the achievement was praised in the Commission Opinion on Poland's accession.[100] Although the second paragraph reintroduces a collective formulation, leading some foreign scholars to conclude that the constitution protects minority rights in both individual and collective terms,[101] the dominant interpretation in Poland is that the new constitution upholds 'an individualised approach to the protection of minorities by using a phrase "Polish citizens belonging to national or ethnic minorities", which is consistent with the currently existing international standards'.[102]

A parallel development may be observed in the drafting of a law on national minorities. The initial text, worked out by a group of specialists from the Helsinki Committee, a Warsaw-based but transnationally organised human rights NGO, followed an entirely individualist approach to minority rights.[103] In ensuing discussions within the Sejm Committee on

[96] Cf the contributions of Andrzej Rzepliński and Leszek Wiśniewski in Constitutional Committee II/14 (07.03.1995), above n 94, 72.

[97] The examples cited included the ICCPR, the CSCE documents and the Framework Convention. Czesław Śleziak (SLD) in Constitutional Committee II/14 (7 March 1995), above n 94, 66.

[98] 'Art. 35: 1. The Republic of Poland ensures Polish citizens belonging to national and ethnic minorities the freedom to maintain and develop their own language, to maintain customs and traditions, and to develop their own culture. 2. National and ethnic minorities have the right to establish educational and cultural institutions designed to protect their religious identity, as well as to participate in the resolution of matters connected with their cultural identity.' Konstytucja Rzeczpospolitej Polskiej z dnia 2 kwietnia 1997 r. [Constitution of the Republic of Poland, 2 April 1997]. Cited in R Chruściak, above n 90, II/389. English translation in: S Łodziński, above n 80, 8.

[99] S Łodziński, above n 80, 8.

[100] Agenda 2000 — Commission Opinion on Polands Application for Membership of the European Union (Brussels 1997) DOC/97/16, 18.

[101] T Diemer-Benedict, 'Die neue Verfassung der Republik Polen' (1997) 43 2/3 *Osteuropa Recht* 226; T Diemer-Benedict, 'Die Grundrechte in der neuen polnischen Verfassung' (1998) 58 *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* 237; A Gawrich, above n 86.

[102] S Łodziński, above n 80, 8. The same conclusion is drawn by P Bajda, M Syposz and D Wojakowski, 'Equality in Law, Protection in Fact: Minority Law and Practice in Poland' in A-M Bíró and P Kovács (eds), *Diversity in Action. Local Public Management of Multi-Ethnic Communities in Central and Eastern Europe* (Budapest, IGI Books and Open Society Institute, 2001) 211.

[103] M Kallas, above n 89, 184. The group was comprised of Zbigniew Hołda, Gregorz Janusz (who served as an advisor to the Minority Committee throughout the process), Marek Nowicki and Andrzej Rzepliński.

National and Ethnic Minorities, the question of group rights emerged several times, but was dismissed by the legal advisor from the Helsinki Committee. Finally, a consensus emerged that '[t]he legislative project regulates the individual rights of minorities, i.e. the rights of persons belonging to a minority' as opposed to 'group rights, which are practically impossible to codify.'[104] In the final version of the draft, the explanatory note stressed that 'by using the construction of individual rights, the bill contains, in accordance with European standards, a catalogue of fundamental rights (…) . Thereby group rights are excluded'.[105] This consensus on the minority protection concept united the pro-minority parties, which formerly had been split along the individual-collective rights line, as well as between special rights and general non-discrimination, behind the 'positive individualist' formula. When the bill was discussed in the first parliamentary reading, support was based predominantly on two arguments: first, the individualist character of the draft, and second, its 'fit' with both the Polish constitution and European standards.[106] Opponents of the bill had two major arguments: first, in reply to the 'positive individualist' presentation of the draft, special minority rights as such were equated with group rights and attacked as privileges violating the principle of (formal) non-discrimination.[107] Second, and mainly to counter the 'European standard' argument of the pro-camp, reciprocity problems were

[104] Henryk Kroll in *Komisja Mniejszości Narodowych i Etnicznych, III kadencja, poszedzienie nr 12 (17 March 1998) [Sejm Committee on National and Ethnic Minorities, 3rd term, session no nr 12 (17 March 1998)]*. Further cited as: *Sejm Committee on National and Ethnic Minorities* [translation from Polish by Guido Schwellnus].

[105] *Komisyjny projekt ustawy o mniejszościach narodowych i etnicznych w Rzeczpospolitej Polskiej (druk nr 616 wpłynał 22 September 1998), uzasadnienie [Committee project of a law on national and ethnic minorities in the Republic of Poland (written matter no. 616, issued 22 September 1998), explanation],* 2 [translation from Polish by Guido Schwellnus].

[106] This line of reasoning was already laid out in the presentation of the project: 'In Art 35/2 of the Constitution the rights of minorities are mentioned. The Framework Convention on National Minorities also speaks about national minorities. (…) [B]ut this in no way changes the fact that (…) no group rights emerge from this law.' Jacek Kuroń (UW) in *Sejm III kadencja, 46 poszedzienie*, (18 March 1999) [Sejm, term III, session 46 (18 March 1999)] [translation from Polish — GS]. Further cited as: *Sejm*. For more pro-arguments based on references to international or European standards see Henryk Kroll (German minority) and Mirosław Czech (UW), in *Sejm III/46* (18 March 1999).

[107] For example: 'The law has to be equal for everybody, not differentiated, so that one group of citizens has other rights than another group, because such a situation would be discriminatory. I concur with the opinion that the bill would differentiate and privilege minorities on the basis of granting them group rights, thereby violating the equality of all citizens of this country. (…) I think that we do not need group or minority rights.' Ewa Sikorska-Trela (AWS), in: *Sejm III/46* (18 March 1999), above note 106 [translation from Polish — GS]. In the same vein, Andrzej Zapałowski, speaking for the extreme rightist KPN and ROP groupings, insisted that 'every Polish citizen, independent of his declared nationality, independent of his opinions or world views, has rights guaranteed in the Constitution. (…) The rights proposed in the law on national and ethnic minorities privilege the minority against the rest of the Polish citizens.' Andrzej Zapałowski, in: *Sejm III/46*, above n 106 [translation from Polish — GS].

invoked by comparing Poland, which supposedly already 'ensures a very high standard of minority rights protection',[108] with the status of Polish minorities in other countries, complaining that 'everything that happened after 1989 from the Polish side with regard to national minorities living in Poland is sadly not reciprocated by our neighbors.'[109] The parliamentary discussion concerning the ratification of the Council of Europe's Framework Convention was conducted roughly along the same lines.[110]

It can be concluded that the consensus favouring a 'positive individual' version of special minority rights, which started from a contestation between individual non-discrimination and collective minority rights positions, was forged by a desire to comply with the European standard under the influence of legal advisors acting as catalysts for the formulation of a shared minority norm conforming to the emerging European standard. The Helsinki Committee was a particularly key player, forming an epistemic community promoting the 'positive individual' model as the only solution in line with European norms and matching the Polish situation. At every stage in the process of norm formulation, the involvement of these legal specialists produced a shift towards an individualised approach. Finally, although the question of EU conditionality was occasionally raised during the debates,[111] it did not play a major role in domestic norm construction and functioned rather as background knowledge about the general importance of minority protection in the accession procedure. But given the lack of a coherent EU model for minority protection and the absence of a high

[108] Marian Piłka (AWS), in: *Sejm III/46*, above n 106 [translation from Polish — GS].

[109] Janusz Dobrosz (PSL), in: *Sejm III/46*, see above n 106 [translation from Polish — GS]. Comparable arguments were brought forward by Andrzej Zapałowski (KPN), Marian Piæka (AWS), Jan Chmielewski (AWS) and Krzysztof Anuszkiewicz (AWS). Another example is the rhetorical question: 'Some of the Sejm members have mentioned European or international standards when it comes to minority rights. I would like to ask, whether it is eg a standard that minority schools in Poland are paid out of the state budget, while in Germany the families have to pay.' Adam Łoziński, in: *Sejm III/46*, above n 106 [translation from Polish by Guido Schwellnus]. On the other hand, only one supportive AWS member brought forward the reverse argument that Poland could serve as a model for other countries by adopting far-reaching minority legislation. Mirosław Kukliński, in: *Sejm III/46*, above n 106.

[110] *Sejm III/65*, above n 106.

[111] When after the debate of the minority provision in the Constitutional Committee in 1995 the outcome was presented in the Sejm Committee on National and Ethnic Minorities, it was added that 'this article has been adopted unanimously. All the indications are that it will be kept, and this will be the key to the European Union.' Jerzy Szteliga (SLD), in: *Sejm Committee on National and Ethnic Minorities II/32*, above n 104, 3 [translation from Polish — GS]. And in the parliamentary debate over the Framework Convention, the question was raised, whether there was 'a certain link with regard to the ratification in the process of negotiation with the European Union.' Tadeusz Iwiński (SLD), in: *Sejm III/65*, above n 106 [translation from Polish — GS]. Although the government representative could not see a direct connection between ratification and accession she nonetheless replied: 'This is undoubtedly one of the most important points, which is monitored all the time in the negotiations.' Podsekretarz Stanu w Ministerstwie Spraw Zagranicznych [Undersecretary of state in the Foreign Ministry] Barbara Tuge-Erecińska, in: *Sejm III/65*, above n 106 [translation from Polish — GS].

adaptational pressure to adopt specific model, the EU option could not play a decisive role in deciding which approach to minority protection should be chosen. Therefore, above all, the standards formulated by the Council of Europe had a major impact on the development of an intersubjective meaning among Polish politicians in favour of a minority norm consistent with European standards.

CONCLUSION: LONG-TERM EFFECTS AND BACKLASH AGAINST THE EU

The previous sections elaborated on the different impact exerted by norm types, such as human rights and minority rights, on the one hand, and norm meanings, such as general non-discrimination and individual or collective forms of special minority rights, on the other. It can be argued that, if the analytical focus is limited so as to distinguish different norm types, and processes of contestation over norm meanings are excluded, this is likely to create unintended consequences for rights politics. To sustain this observation empirically, we have reconstructed the emergence of contested norm meanings regarding minority protection in the process of EU enlargement, focusing on the construction of meaning through interactions within international, European and national contexts. A discursive analysis of norm construction and meaning in the three different country cases of Hungary, Romania and Poland demonstrates that norm contestation is an ongoing process. That is to say, it is not limited to the construction of international and European norms prior to their respective application in the EU's policy of conditionality or to the process of compliance and domestic rule adoption on the part of the applicant states during the conditionality phase. The story does not end once the accession conditions are fulfilled, or at the moment of full membership. Instead, it is expected that the contestation of minority rights implies unintended long-term effects in the accession countries, as well as potential backlash against the EU after accession.

This concluding section offers an account — albeit speculative — of this possible backlash. A first set of effects concerns the feedback of external minority policies into the internal EU system. It can be concluded that such an influence has already taken place insofar as minority rights have been clearly and persistently placed on the agenda of EU politics, internally as well as externally. However, while the end of the Cold War clearly constituted a critical juncture with regard to general concern over minorities within the international context, the impact of this juncture remains limited to the EU's external policies. Internally, it triggered a development within the existing path of non-discrimination, leading to a gap between the conceptual approaches to minority protection taken in both contexts.

In turn, this chapter claims that the non-discrimination track pursued in the internal EU context, on the one hand, and the domestic minority protection norms developed by the accession states under influence of the EU's external policy of conditionality, on the other, follow path dependent developments, and, once institutionalised, the gap is not easily closed. Indeed, our research suggests that it is likely to provoke enduring contestation about the meaning of minority rights, and stands to cause unintended, yet long-term consequences. These effects will become particularly salient once the accession procedure is complete and the accession states are full members of the EU.

Secondly, it is important to address the issue of whether, and if so how, changes in the internal *acquis communautaire* influenced the external and enlargement policies, leading to a realignment of both tracks. For example, the EU increasingly linked its justifications for the minority criterion with the resonance points developing in the internal *acquis*, namely non-discrimination, cultural diversity and the fight against racism and xenophobia.[112] Thus, the EU's 1999 report on human rights states that 'compliance with the principle of non-discrimination is an important element in the EU enlargement process. The European Council in 1993 included in the Copenhagen criteria a requirement that the candidate country respect and protect minorities.'[113] And in 2001, when one of the focal points of the human rights report was the fight against racism and xenophobia, which 'lies at the core of the European Union human rights policy,'[114] a Commission report on that very issue noted that '[t]he notion of the respect for and protection of minorities is a key element in the fight against racism, xenophobia and anti-Semitism in the applicant countries.'[115] Furthermore, a Commission communication regarding the 'European Union's Role in Promoting Human Rights and Democratisation in Third Countries,' which sets out to 'promote coherence between the EU's internal and external approaches',[116] listed among the thematic priorities for EU action '[c]ombating racism and xenophobia and discrimination against minorities' as 'an area where the EU has significant internal as

[112] G Schwellnus, above n 21.
[113] 'EU Annual Report on Human Rights 1999' *Council of the European Union* <http://ue.eu.int/pesc/human_rights/main99_en.htm> (20 February 2004) 36.
[114] 'European Union Annual Report on Human Rights 2001' *Council of the European Union* <http://europa.eu.int/comm/external_relations/human_rights/doc/report01_en.pdf> (26 February 2004) 12.
[115] 'Commission report on the implementation of the Action Plan against Racism — Mainstreaming the fight against racism' *Commission of the European Communities* 11; Communication 'The European Union's Role in Promoting Human Rights and Democratisation in Third Countries' *Commission of the European Communities* COM(2001) 252.
[116] 'Communication of the Commission "Countering Racism, Xenophobia and Anti-Semitism in the Candidate Countries' *Commission of the European Communities* COM(1999) 256, 3.

well as external policy competence.'[117] In addition, the focus increasingly shifted from national minorities — especially the Hungarian minorities in Romania and Slovakia — to the situation of the Roma and therefore from (collective) minority protection to issues of non-discrimination. While this is largely due to the Roma issue having become part of the EU's 'security agenda,' with the increase of Roma migration from applicant to EU member states, it can nonetheless facilitate attempts to develop a 'coherent' approach towards minority issues. It remains to be seen whether this is a largely rhetorical strategy to fend off claims of double standards, or will in turn lead to the institutionalisation of minority rights within the boundaries of Article 6 TEU as the prime human rights foundation of the Union.

Finally, and perhaps most importantly, long-term effects on the minority protection systems in the accession countries may be expected after accession is completed. Shortly before accession, the signals still remain mixed. On one hand, there are encouraging signs that the EU system is, if not supportive, at least permissive regarding the stipulation of far-reaching national minority protection. Consider the ECJ's rulings on language requirements and especially the 'legitimate aim' dictum in the *Bickel/Franz* case.[118] Nonetheless, the Court has not yet established minority protection as a general principle of law,[119] and it remains to be seen whether and how it will support national minority protection systems if and when they contradict Community aims. It is unlikely, however, that the Court will directly strike down national minority rights protection, given its cautious approach in cases dealing with the autonomy status of South Tyrol, which can be regarded as the most important 'test case' for the compatibility of far-reaching national minority protection and the EU's legal order.[120] The potential downside of the ECJ rulings regarding minority protection consists in their lack of appreciation of special minority rights as generally taking priority over the aims of market liberalisation, and their limitation of minority rights to cases in which it can be clearly established that protective measures would be 'undermined if the rules in issue were extended to cover [...] nationals of other Member States exercising their right to freedom of movement.'[121] In effect, measures aimed at the protection of a

[117] *Ibid*, 17.
[118] Case C-274/96 *Bickel/Franz* [1998] ECR I-7637, s 29.
[119] G Toggenburg, above n 38, 19.
[120] R Streinz, 'Minderheiten- und Volksgruppenrechte in der Europäischen Union' in D Blumenwitz and G Gornig (eds), *Der Schutz von Minderheiten- und Volksgruppenrechten durch die Europäische Union* (Köln, Verlag Wissenschaft und Politik, 1996) 11–29, 28.
[121] *Bickel/Franz* above, n 43, s 29. In this case, the court saw no undermining effects when the right in question — that a trial against a German speaker is to be held in German language upon request — was also granted to other German-speaking EU nationals and therefore ruled against the Italian government, which had argued that the measures were designed to protect the German minority and for that reason only to be applied to German-speaking Italian citizens.

particular minority group are only accepted when they are also granted to residents[122] or even visitors[123] from other EU countries, unless the negative effects of such an inclusive approach are clearly demonstrable. The liberalising thrust of the ECJ rulings towards the inclusion of non-national and non-resident EU citizens is paralleled by the inclusive application of Article 13 and the Directives 2000/43[124] and 2000/78,[125] which are applicable to all persons, even third country nationals. This fact points towards a potential tension with the minority systems established in the CEE countries when measured by European standards and EU conditionality.

Perhaps the most striking example of the 'conceptual double standard' paradox lingering over the enlargement process is that the EU's external minority policy explicitly endorses the European minority protection standard of both the Council of Europe and the OSCE. That is, it accepts a standard which includes or, at least tolerates, a restriction to citizens that the UN standard does not. In turn, national legislation based on this principle stands to be undermined by Community law once the CEE countries have joined the EU. While this is not necessarily a legal problem, and might indeed even strengthen rather than weaken the minority protection system (as the ECJ argued in the *Bickel/Franz* case), the potential political reverberations in the CEE countries, where the domestic consensus on minority protection is often fragile, could have strong negative consequences, since it could affect the willingness of national authorities to grant or uphold far-reaching rights to minorities, when the minority can be enlarged, so to speak, by migration.

References

Adler, E and Haas, P (1992) 'Conclusion: epistemic communities, world order, and the creation of a reflective research program' 46(1) *International Organization* 367.

Amato, G and Batt, J (1998) 'Minority Rights and EU Enlargement to the East. Report of the First Meeting of the Reflection Group on the Long-Term Implications of EU Enlargement: The Nature of the New Border' *European University Institute* (RSC Policy Paper 98/5, Florence).

Bajda, P Syposz, M and Wojakowski, D (2001) 'Equality in Law, Protection in Fact: Minority Law and Practice in Poland' in A-M Bíró and P Kovács

[122] Case 137/84 *Mutsch* [1985] ECR 2681. For a discussion see B De Witte 1999, above n 43; G Toggenburg 'Der Europäische Gerichtshof — unverhoffter Anwalt der Minderheiten Europas?' *Academia* 18 (March-June, 1999) 7–9.
[123] Case C-274/96 *Bickel/Franz* [1998] ECR I-7637.
[124] See above, n 40.
[125] See above, n 39.

(eds), *Diversity in Action. Local Public Management of Multi-Ethnic Communities in Central and Eastern Europe* (IGI Books and Open Society Institute, Budapest).

Barry, B (2001) *Culture and Equality. An Egalitarian Critique of Multiculturalism* (Polity Press, Cambridge).

Bartsch, S (1995) *Minderheitenschutz in der internationalen Politik. Völkerbund und KSZE/OSZE in neuer Perspektive* (Westdeutscher Verlag, Opladen).

Betten, L and Grief, N (1998) *EU Law and Human Rights* (Longman, London/New York).

Blumenwitz, D and Pallek, M (2000) 'Draft of a minority protection clause in the Charter on Fundamental Rights of the European Union. Contribution by the International Institute for Right of Nationality and Regionality' CHARTE 4301/00 CONTRIB 173 49 (17/05/2000).

Börzel, T and Risse, T (2000) 'When Europe Hits Home: Europeanization and Domestic Change' 4 *European Integration online Papers* 15.

Brunner, G (1999) 'Minderheitenrechtliche Regelungskonzepte in Osteuropa' in G Brunner and B Meissner (eds), *Das Recht der nationalen Minderheiten in Osteuropa* (Spitz, Berlin).

Brusis, M (2003) 'The European Union and Interethnic Power-sharing Arrangements in Accession Countries' *Journal of Ethnopolitics and Minority Issues in Europe* 1.

Bulmer, S and Burch, M (2001) 'The "Europeanisation" of Central Government: the UK and Germany in Historical Institutionalist Perspective' in M Aspinwall and G Schneider (eds), *The Rules of Integration. Institutionalist Approaches to the Study of Europe* (Manchester University Press, Manchester).

Charpentier, L (1998) 'The European Court of Justice and the Rhetoric of Affirmative Action' 4(2) *European Law Journal* 167.

Chayes, A and Handler Chayes A (1993) 'On Compliance' 47(2) *International Organization* 175.

—— (1995) *The New Sovereignty. Compliance with International Regulatory Regimes* (Harvard University Press, Cambridge and London).

Checkel, J (1998) 'The Constructivist Turn in International Relations Theory' 50 *World Politics* 324.

Chruściak, R (1997) (ed), *Projekty Konstytucji* 1993-1997 [*Constitutional Projects* 1993–1997]. II cześci [2 volumes] (Wydawnictwo Sejmowe, Warszawa).

Delcourt, C (2001) 'The *acquis communautaire*: Has the Concept Had Its Day?' 38 *Common Market Law Review* 829.

De Witte, B (1999) 'Free Movement of Persons and Language Legislations of the Member States of the EU. Some Reflectionsafter the Recent Judgement in Bickel and Franz' 18 *Academia* 1.

—— (2000) 'Politics Versus Law in the EU's Approach to Ethnic Minorities' *European University Institute* (Working Paper No RSC 2000/4, Florence).

Diemer-Benedict, T (1997) 'Die neue Verfassung der Republik Polen' 43, 2/3 *Osteuropa Recht* 222.

—— (1998) 'Die Grundrechte in der neuen polnischen Verfassung' 58 *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* 204.

DiMaggio, P and Powell, W (1991) 'Introduction' in W Powell and P DiMaggio (eds), *The New Institutionalism in Organizational Analysis* (University of Chicago Press, Chicago) 1.

Donnelly, J (2003) 'The Universal Declaration Model of Human Rights: A Liberal Defense' in G Lyons and J Mayall (eds), *International Human Rights in the 21st Century: Protecting the Rights of Groups* (Rowman & Littlefield, Lanham).

Eide, A (1993) 'Protection of Minorities. Possible ways and means of facilitating the peaceful and constructive solution of problems involving minorities' *UN Commission on Human Rights, Sub-Commission on the Prevention of Discrimination and Protection of Minorities* (Report submitted by the Special Rapporteur 45th session, 10 August 1993) UN Doc. E/CN.4/Sub.2/1993/34.

—— (1999) 'Citizenship and the Minority Rights of Non-Citizens' (Working paper submitted to the *UN Commission on Human Rights, Sub-Commission on the Promotion and Protection of Human Rights,* Working Group on Minorities, 5th session, 25–31 May 1999) UN Doc. E/CN.4/Sub.2/AC.5/1999/WP.3.

—— (2000) 'Commentary to the Declaration on the Rights of Persons Belonging to National or Ethnic, Religious and Linguistic Minorities' (Working paper submitted to the *UN Commission on Human Rights, Sub-Commission on the Promotion and Protection of Human Rights,* Working Group on Minorities, 6th session, 22–26 May 2000) UN Doc. E/CN.4/Sub.2/AC.5/2000/WP.1.

Finnemore, M (1996a) 'Constructing Norms of Humanitarian Intervention' in P Katzenstein (ed), *The Culture of National Security. Norms and Identity in World Politics*. (Columbia University Press, New York).

—— (1996b) 'Norms, culture, and world politics: insights from sociology's institutionalism' 50(2) *International Organization* 325.

Finnemore, M and Sikkink, K (1998) 'International Norm Dynamics and Political Change' 52(4) *International Organization* 887.

Franck, T (1995) *Fairness in International Law and Institutions* (Clarendon Press, Oxford).

Gawrich, A (2001) *Ethnische Minderheiten im Transformations- und Konsolidierungsprozess Polens — Verbände und politische Institutionen* (Unpublished dissertation, Bochum).

Gialdino, C (1995) 'Some Reflections on the *acquis communautaire*' 32 *Common Market Law Review* 1089.

Grabbe, H (2001) 'How does Europeanization affect CEE governance? Conditionality, diffusion and diversity' 8(6) *Journal of European Public Policy* 1013.

Grabbe, H and Hughes, K (1998) *Enlarging the EU Eastwards* (The Royal Institute of International Affairs, London).

—— (2002) 'EU-Minderheitenpolitik und kollektive Minderheitenrechte' 52(5) *Osteuropa* 598.

Hofmann, R (1992) 'Minderheitenschutz in Europa. Überblick über die völker- und staatsrechtliche Lage' 52 *Zeitschrift für ausländisches öffentiches Recht und Völkerrecht* 1.

Horváth, I and Scacco, A (2001) 'From the Unitary to the Pluralistic: Fine-Tuning Minority Policy in Romania' in A-M Bíró and P Kovács (eds), *Diversity in Action. Local Public Management of Multi-Ethnic Communities in Central and Eastern Europe* (IGI Books and Open Society Institute, Budapest).

Hughes, J and Sasse, G (2003) 'Monitoring the Monitors. EU Enlargement Conditionality and Minority Protection in the CEECs' *Journal of Ethnopolitics and Minority Issues in Europe* 1.

Jacobson, D (1996) *Rights Across Borders: Immigration and the Decline of Citizenship* (Johns Hopkins University Press, Baltimore).

Jepperson, R, Wendt, A and Katzenstein, P (1996) 'Norms, Identity, and Culture in National Security' in P Katzenstein (ed), *The Culture of National Security. Norms and Identity in World Politics*. (Columbia University Press, New York).

Keck, M and Sikkink, K (1998) *Activists Beyond Borders: Advocacy Networks in International Politics* (Cornell University Press, Ithaca).

Kieser, A (1999) 'Konstruktivistische Ansätze' in A Kieser (ed), *Organisationstheorien* 3rd edn (Kohlhammer, Stuttgart et al).

Klotz, A (1995) *Norms in International Relations: The Struggle Against Apartheid* (Cornell University Press, Ithaca/London).

Koh, H H (1997) 'Why Do Nations Obey International Law?' 106 *The Yale Law Journal* 2599.

Kallas, M (1995) 'Parlamentarische Arbeiten am Status der nationalen und ethnischen Minderheiten in Polen' 41(3) *Osteuropa Recht* 173.

Krizsán, A (2000) 'The Hungarian Minority Protection System: a flexible approach to the adjudication of ethnic claims' 26(2) *Journal of Ethnic and Migration Studies* 247.

Kymlicka, W (2001) 'Reply and Conclusion' in W Kymlicka and M Opalski (eds), *Can Liberal Pluralism be Exported? Western Political Theory and Ethnic Relations in Eastern Europe* (Oxford University Press, Oxford/New York).

Legro, J (1997) 'Which norms matter? Revisiting the "failure" of internationalism' 51(1) *International Organization* 31.

Łodziński, S (1999) 'Minority Rights in Poland' (Report by the Helsinki Comvmittee in Poland).

March, J and Olsen, J (1989) *Rediscovering Institutions. The Organizational Basis of Politics* (Free Press, New York).

—— (1998) 'The Institutional Dynamics of International Political Orders' 52(4) *International Organization* 943.

Marcussen, M, Risse, T, Engelmann-Martin, D, Knopf, H-J and Roscher, K (1999) 'Constructing Europe? The evolution of French, British and German nation state identities' 6(4) *Journal of European Public Policy* 614.

Michalski, A and Wallace, H (1992) *The European Community: The Challenge of Enlargement* (Royal Institute of International Affairs, London).

Mohlek, P (1994) 'Der Minderheitenschutz in der Republik Polen' in P Mohlek and M Hošková (eds), *Der Minderheitenschutz in der Republik Polen, in der Tschechischen und in der Slowakischen Republik* (Kulturstiftung der deutschen Vertriebenen, Bonn).

Niewerth, J (1996) *Der kollektive und der positive Schutz von Minderheiten und ihre Durchsetzung im Völkerrecht* (Duncker & Humblodt, Berlin).

North, D (1990) *Institutions, Institutional Change and Economic Performance* (Cambridge University Press, Cambridge).

Open Society Institute (2001a) *Monitoring the EU Accession Process: Minority Rights — Minority Protection in the EU Accession Process* (Open Society Institute, Budapest).

—— (2001b) *Monitoring the EU Accession Process: Minority Rights — Minority Protection in Hungary* (Open Society Institute, Budapest).

—— (2001c) *Monitoring the EU Accession Process: Minority Rights — Minority Protection in Poland* (Open Society Institute, Budapest).

—— (2001d) *Monitoring the EU Accession Process: Minority Rights — Minority Protection in Romania* (Open Society Institute, Budapest).

Pentassuglia, G (2001) 'The EU and the Protection of Minorities: The Case of Eastern Europe' 12(1) *European Journal of International Law* 3.

Pierson, P (1996) 'The Path to European Integration: A Historical Institutionalist Analysis' 29(2) *Comparative Political Studies* 123.

Ram, M (2001) 'Minority Relations in Multiethnic Societies: Assessing the European Union Factor in Romania' 1(2) *Romanian Journal of Society and Politics* 63.

Ratner, S (2000) 'Does International Law Matter In Preventing Ethnic Conflict?' 32 *Journal of International Law and Politics* 591.

Schwellnus, G (2001) '"Much ado about nothing"? Minority Protection and the EU Charter of Fundamental Rights' *Institute of European Studies Queen's University of Belfast* (ConWEB Paper 5/2001).

Shafir, M (2001) 'The Political Party as National Holding Company: The Hungarian Democratic Federation of Romania' in J Stein (ed), *The*

Politics of National Minority Participation in Post-Communist Europe — State-Building, Democracy, and Ethnic Mobilization (M.E. Sharpe, Armonk and New York) 101.

Sikkink, K (1993) 'Human rights, principled issue networks, and sovereignty in Latin America' 47(3) *International Organization* 411.

Streinz, R (1996) 'Minderheiten- und Volksgruppenrechte in der Europäischen Union' in D Blumenwitz and G Gornig (eds), *Der Schutz von Minderheiten- und Volksgruppenrechten durch die Europäische Union* (Verlag Wissenschaft und Politik, Köln).

Thelen, K and Steinmo, S (1992) 'Historical institutionalism in comparative politics' in S Steinmo, K Thelen and F Longstreth (eds), *Structuring politics: Historical institutionalism in comparative analysis* (Cambridge University Press, Cambridge).

Thiele, C (1999) 'The Criterion of Citizenship for Minorities: The Example of Estonia' *European Center for Minority Issues* (ECMI Working Paper no 5, Flensburg).

Thornberry, P (1991) *International Law and the Rights of Minorities* (Clarendon, Oxford).

Tkaczynski, J and Vogel, U (1997) 'Sieben Jahre nach der Wende: Die polnische Verfassung zwischen Oktroi und Obstruktion' 43 2/3 *Osteuropa Recht* 169.

Toggenburg, G (1999) 'Der Europäische Gerichtshof — unverhoffter Anwalt der Minderheiten Europas?' 18 *Academia* 7.

—— (2000) 'A Rough Orientation Through a Delicate Relationship: The European Union's Endeavours for (its) Minorities' 4(16) *European Integration online Papers*.

Tontsch, G (1995) 'Der Minderheitenschutz in Rumänien' in G Brunner and G Tontsch (eds), *Der Minderheitenschutz in Ungarn und Rumänien* (Kulturstiftung der deutschen Vertriebenen, Bonn).

—— (1999) 'Die Rechtsstellung der Minderheiten in Rumänien' in G Brunner and B Meissner (eds), *Das Recht der nationalen Minderheiten in Osteuropa* (Spitz, Berlin).

Van Waarden, F and Drahos, M (2002) 'Courts and (epistemic) communities in the convergence of competition policies' 9(6) *Journal of European Public Policy* 913.

Vermeersch, P (2003) 'EU Enlargement and Minority Rights Policies in Central Europe: Explaining Policy Shifts in the Czech Republic, Hungary and Poland' *Journal of Ethnopolitics and Minority Issues in Europe* 1.

Wiener, A (1998) 'The Embedded *acquis communautaire*. Trans-mission Belt and Prism of New Governance' 4(3) *European Law Journal* 294.

—— (2001) 'Zur Verfassungspolitik jenseits des Staates: Die Vermittlung von Bedeutung am Beispiel der Unionsbürgerschaft' 8(1) *Zeitschrift für Internationale Beziehungen* 73.

21

The Fifth Enlargement: More of the Same?

A COMMENT BY FRANK EMMERT

THE COMMON THEME in this section is 'Implementing the *acquis communautaire* and Domestic Institution Building'. I took this theme to require that we climb down from the lofty heights of constitution building to the more profane issues of initial and subsequent day-to-day application of European Union law in the new Member States. However, the four authors approach the theme in rather different ways.

András Sajó and Mirosław Wyrzykowski focus on the constitutional debate prior to accession in Hungary and Poland, respectively. They show how the question of retaining sovereignty, as opposed to transferring considerable amounts of state power to joint decision-making in Brussels, is controversially discussed in their respective countries, and how this is regulated in the countries' respective constitutions. Sajó presents some comparative analysis and asks whether there is a uniquely Central and Eastern European approach to the question.

At least to some of us Westerners, the entire debate may seem out of place. The lofty notion of sovereignty is often used and seldom defined. Many of its strongest supporters seem like foot soldiers of Louis XIV and his notion that 'L'Etat — c'est moi!' For the rest of us, the days when sovereignty really mattered are long gone, in particular if you live in a small country, or for that matter in any country other than the United States with its frequent disregard for international law and its defense budget of 400 billion dollars — which is roughly equivalent to the total defense spending of the rest of the world combined. Sovereignty is so 18th and 19th century, while interdependence is much more 20th and 21st century. And the Swiss government — to give just one example — can sing a song or two about not being able to sit at the table where the decisions that really matter in Europe are being taken. Consequently, Ingolf Pernice and many others argue that a discourse on sovereignty is the wrong approach to EU enlargement.

However, Pernice and I write as Germans, ie from the perspective of a country that got itself and the rest of the world into a whole lot of awful trouble the last time it exercised what it thought was its full sovereignty. Readers of this book may well be from a country that has been an active — and voluntary — participant in all kinds of multilateral regimes and activities over the past decades, from a country where at least the political mainstream subscribes to the notion that delegation of powers from domestic to international institutions should be seen as an execution of sovereignty and not only a limitation.

By contrast to more fortunate Western European countries, both Hungary and Poland were denied their full sovereignty for the last 40 years and have suffered immensely from it. Thus, the saying in these countries that 'we just got out of one union — the Soviet Union — why should we join another one in a hurry' has to be understood in historical context. This makes their debate on sovereignty so difficult but also so important. Support for and legitimacy of the EU will quickly fade away when the honeymoon is over and the daily chores have to be distributed, unless the marriage as such was agreed to by the marriage partners, rather than arranged by the parents.

This also explains why all Central and Eastern European candidates have opted for public referenda on accession, even those that are not constitutionally required to do so. Referenda, of course, are not unproblematic and both Sajó and Wyrzykowski have considerable reservations about their use in the present context.

Now that the hurdle has been successfully taken by both Hungary and Poland, we may ask whether their lack of enthusiasm for referenda will persist. Mine certainly will, but of course, here I represent Estonia, where opinion polls long suggested that the outcome of the referendum was all but sure: Estonia used to count about 35% of its population in favour of EU accession with some 35–45% against. Then, in early summer 2001, Estonia won the Eurovision song contest. Instantly, support for EU accession jumped to almost 60%, and remained above 50% for many months. I almost became a fan of shallow *Schlagermusik*. Now that almost 67% of the Estonian voters approved their country's membership in the EU, we might say that all is well that ends well. But that's what Russian roulette players also say as long as they can still say something …

The other chapters focus more on the method of bringing the rule of EU law to the accession countries. Antje Wiener deals with the evolving potential for conflict arising out of a bifurcated phenomenon: (i) on the one hand, the EU sets the criteria and preconditions for accession, imposing a process of institutional adaptation, in which the candidates not only have no say but are confronted with a number of unfair/discriminatory prescriptions; (ii) on the other hand, the EU is also a moving target, in the middle of a process of constitutionalisation, to which the candidate countries were

merely invited but in which they had no voice (in the sense of a vote). The phenomenon is rooted in the structure of the EU, where all important decisions — defined as constitutional decisions — and any others that are deemed important by at least one Member State generally require a unanimous vote. This makes the EU extremely inflexible towards outsiders, as candidates and other third parties essentially need to please all existing members before any treaty will be signed. It also makes the EU rather flexible on the inside, as exceptions will frequently be granted by those that want change and progress to those who do not.

Ultimately, Wiener predicts problems. The transition from the logic of compliance among candidate countries to the logic by compliance by Member States ('anarchy vs integration') will be difficult for countries which at the same time do not share five decades of joint interpretation and are increasingly treated as second class members of the family. We may see acceptance of formal legitimacy of EU law in the new Member States, but not so much acceptance of social legitimacy; formal compliance, but not real or practical compliance; application of the letter of the law, but not its spirit; and, breaches of the rules if they hurt, where countries believe they can get away with it. Wiener calls this 'conflictive compliance'.

My comment better takes the form of a question: To what extent will the contribution by countries such as Hungary and Poland in the end really differ from the contribution that has been made in the past by other 'difficult' Member States, such as Italy, where EU law is formally widely supported but practically often ignored, or the UK, where EU law is practically followed diligently *ex post*, but formally often contested *ex ante*? My question is, therefore, will we not just see more of the same? Is Poland not just learning the game, ie how to negotiate toughly in the best national interest, just as the old Member States have taught us? And are the Central and Eastern Europeans not just going to use occasional non-compliance as a safety valve or a mechanism opening necessary but formally unforeseen transitional periods, just as the old Member States have done? Whether or not this will lead to destructive disputes and problematic erosion of the rule of law probably depends on the degree and frequency of non-compliance. What worries me is the fact that the Central and Eastern European countries have some 50 years of experience with the formal application of the foreign/Soviet imposed laws and five year plans without breaking their backs, ie without true compliance. In this respect, we can only hope that the fact that Soviet rule was imposed and EU law was not will make some difference. This, of course, brings us back full circle to the importance of the debate on sovereignty and the legitimacy of accession, both in a procedural and social sense.

Finally, a happy ending. Roland Bieber and Micaela Vaerini develop a theoretical framework for the analysis of non-coercive means of promoting

formal compliance with and practical implementation of EU law, both in the existing Member States and in the accession countries. I fully agree with Joanne Scott that this is an important contribution to the field of 'law in context' because the soft measures outlined here are often overlooked or at least underestimated by us lawyers.

22

Accession's Internal Dimension in the New Member States

A COMMENT BY JOANNE SCOTT

THE CONTRIBUTION BY Bieber and Vaerini is an antidote to the court-centrism which we EU lawyers tend to exhibit. They are concerned with the limits on Member State autonomy in the implementation of Community law. The ECJ, they tell us, has established two principal limitations: the twin notions of effectiveness and non-discrimination. Yes, yes, we all cry, being familiar with the raft of illustrative case law and the multitude of books and articles by academic lawyers and practitioners on the subject. Bieber and Vaerini go on, however, to pose a series of rhetorical questions:

> Is it permissible, for example, for EC legislation to impose further conditions on the exercise of implementing powers? May it lay down substantive and /or procedural rules of implementation? May it impose specific methods of implementation on the member states, such as establishing the participation of private associations? May it mandate a decentralised implementation by regional and local authorities? May it even foster new governance structures for the sake of making implementation more effective?

A first reaction may be one of consternation. What does it mean to ask 'is it permissible'? What does it mean to ask 'may it'? Whether or not it is permissible to do so, ie, whether or not the EC legislature 'may' do so, the EC legislature in fact routinely circumscribes Member State autonomy in implementation by establishing a range of procedural requirements which shape Member State implementation practices in various, often profound, ways. Much of my own work has been concerned to illustrate this, notably in relation to the implementation of environmental law and of structural funding. Bieber and Vaerini offer many interesting examples which they situate on a spectrum between 'coercive' and 'soft' and in two distinct contexts, namely existing Member States and accession states. They assert — correctly in my view — that increasing EU involvement in national administration is

not confined to the accession states, but is a feature of the unique experiment in multi-level governance which is the EU.

Bieber and Vaerini are concerned, however, to look beyond the descriptive in their analysis of the 'post-legislative'. They also question the legal and normative basis for the developments under discussion. Again, they pose a series of rhetorical questions:

> What are the legal and conceptual justifications for any such restrictions on the discretion of the Member States in determining how to implement EU law? Do such restrictions render the Member States' discretion in deciding how to implement EC law illusory? How are EC interventions of this sort themselves to be limited? And how can they be prevented from unduly interfering with the Member States' performance of their responsibilities?

When Bieber and Vaerini ask these sensible questions, consternation gives way to bewilderment. What is striking first is the intense 'ad-hockery' of the manner in which the EU constrains Member State autonomy in implementation. At the risk of over-simplifying, responsibility for the implementation of EC legislation will fall either to Community level actors or to the Member States. as responsibility accrues at Community rather than Member State level, an ever more elaborate framework for the exercise of implementing powers has evolved. Ad-hockery has given way to systems. The regulation of 'comitology', by way of legislation and by way of case-law, offers a paradigm example. Significant also are the proposals in the current draft constitutional treaty which would subject the delegation of powers to the European Commission to detailed arrangements entailing oversight by the European Parliament. Long gone is the idea that the 'post-legislative' is somehow unimportant.

But this stands in real contrast to the regulation of Member State implementation. As to the latter, we find a treaty article on transparency here, and a treaty provision on participation there. Arrangements may even be elaborate; they may require the establishment of ambitious institutional frameworks for multi-level, multi-actor, public/private partnerships. But they are still ad hoc, the product of the legislative whim, unconstrained — it would seem — by any constitutional framework based upon some prior conception of good governance. Again, it is telling in this regard that the Convention on the Future of Europe did not accept the suggestion by the Working Group on Complementary Competences that, in view of the common interest in the quality of national administration of EU legislation, the EU be authorised to assist Member States' implementation by facilitating the exchange of information and persons relating to administration and to support common training and development. The Working Group proposed that this be explicitly added to Article 15, as an additional area of supporting measures. We know that this is already happening, but still the silence of the Treaty seems likely to persist.

What is striking, second, is just how little discussion there has been amongst lawyers about the legal and normative dimensions of Community constraints on Member State implementation. These constraints tend to be smuggled in, as if mere accompaniments to the main dish. This lack of visibility goes hand in hand with a lack of critical engagement. Bieber and Vaerini represent a worthy exception. Copious ink has been spilt by lawyers celebrating or bemoaning the European Court's covert harmonisation of Member State legal systems. The Court can barely move, without being accused of enforcing assimilation. Yet, lawyers have scarcely uttered a word about the ever-increasing impact of Community legislation on Member State governance processes for implementation. As Bieber and Vaerini acknowledge, this seems to be the flip-side of flexibility. In certain areas at least (and the examples offered Bieber and Vaerini are many and diverse), substantive flexibility is increasingly accompanied by procedural intervention. Member States retain autonomy in implementation as long as they go about it the right way. This may be viewed principally from an effectiveness perspective, as facilitating better outcomes and enhanced compliance. However, the values being pursued — transparency and participation, notably — make it difficult not to perceive an additional dimension, concerned less with effectiveness than with legitimacy, that is, with good governance at the Member State level.

How complex then, and how different, is the world into which the accession states will enter, relative even to the United Kingdom and Ireland in 1972. In the case of the United Kingdom, the 'post-legislative' was clearly not high on the political agenda. With hindsight it seems remarkable, even remarkably naïve, that the Act of Parliament which paved the way, internally, for British membership provided for the exercise of delegated powers in the adoption of regulations implementing Community acts. In the United Kingdom, we still slip with worrying ease into the language of 'transposing' Community directives. The two go together of course. It would be foolish to waste Parliament's precious time in the mundanities of the mechanical 'post-legislative'. Needless to say, the world has changed, but the Act has not, thus leaving a great gaping legitimacy gap which persists in the face of long-awaited, much needed, constitutional modernisation.

This history only lends greater interest to the question of accession's internal dimension in the new Member States. As to this, the relevant chapters offer us rare access and rare insight. What is striking — and Hungary would seem to be a prime example in this respect — is the contrast between the 'big' picture in terms of the accession moment and the 'little' picture in terms of the day-to-day exercise of powers as members of the EU. Requirements for parliamentary supermajorities, combined with popular referenda, operate to blanket accession in a shroud of 'gross legitimacy'. In the case of Hungary, this is achieved at a price. Recourse to 'gag-rules' and strategic silences in areas of intense political contestation tend to leave unresolved fundamental issues, such as supremacy and the participation of

national parliaments in European level legislative processes. How familiar this all sounds to a UK lawyer. One wonders whether in Hungary, as in the UK, the consequence of this strategy will be to vest more power in the courts to determine constitutional questions of prime importance.

As noted, one of the issues yet to be resolved relates to the role of the Hungarian parliament in relation to EU legislative processes. This is to be determined by a law to be passed by a two-thirds majority. Sajo hints that expectations should not be too high; the language deployed being that of 'harmonisation,' language which normally equates with mere consultation.

Moving further down the decision making chain to the all-important implementation phase, Sajo observes:

> The emerging new division of powers takes away Parliament's legislative powers in matters that are of Union competence, while leaving unclear the scope of legislative powers relating to implementing legislation.

Thus, as we proceed from membership, to legislation, to implementation, the picture becomes more uncertain and more troublesome. Sajo anticipates a weakening of checks and balances in this regard. Sensitive though he is to this issue, he too slips into language which could easily be misconstrued. 'Are constitutional courts,' he asks, 'going to strike down executive regulations that simply implement community legislation'? But as Bieber and Vaerini demonstrate, in our new super-flexible Europe, there is no longer going to be anything *simple* about the task of implementation.

'Comitology' used to be shorthand for pernicious technocracy. Even if one does not accept its supposed resurrection as deliberative utopia, the fact remains that as a mechanism for implementation, it has been subject to important, largely positive, transformations over recent years. Parliamentary oversight has combined with transparency to inject a degree of accountability into this governance mode. As noted, 'delegation,' as conceived in the draft constitutional text, will also be accompanied by mechanisms designed to enhance effective oversight and even control. One can quibble with the detail, but the idea is simple and sound. Still, the idea that implementing powers should be vested in the Member States remains intuitively appealing. It would seem to be in keeping with core values such as subsidiarity and proportionality, as well as appropriately respectful of the diversity which characterises the widening EU. Nonetheless, the question remains: Ought the EU's interest in good governance stop at the doors of the Member States? As the importance of the implementation task grows, ought the Member States to retain freedom to undertake that task in accordance with their own conception of good or appropriate governance, regardless of the degree of executive dominance that this might imply, and regardless of whether the language of 'implementation' is being used to bypass established structures of parliamentary governance? As Bieber and Vaerini show,

the EU has started down the road of shaping Member State implementation practices. This is a fact which raises profound questions of constitutional importance. What we need is a constitutional convention ….!

Index